Supreme Court, U.S.
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No. ____

In The
Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE # 1, and MARK HEACOCK,
Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,
Respondent.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, NW
Washington, DC 20008
(202) 237-8165
jaffe@esjpc.com

QUESTIONS PRESENTED

Forty-six States and numerous tobacco companies have signed an irrevocable agreement, called the Master Settlement Agreement ("MSA"), which divides markets, suppresses price competition, and restricts competitive advertising, with the purpose and effect of increasing both tobacco company profits and state revenues. It is undisputed that this agreement would violate the antitrust laws if entered into by the tobacco companies alone.

The questions presented are:

1. Whether a binding agreement among multiple States and private companies is immunized from antitrust scrutiny under the state-action immunity doctrine of *Parker* v. *Brown*, 317 U.S. 341 (1943).

2. Whether a binding agreement among multiple States, with both intrastate and interstate effects, violates the Compact Clause, Article I, § 10, cl. 3 of the United States Constitution, in the absence of congressional approval.

PARTIES TO THE PROCEEDINGS BELOW

Petitioner S&M Brands, Inc., is a cigarette manufacturer that has not joined the MSA. Petitioner Tobacco Discount House # 1 is a retail tobacco store in Louisiana. Petitioner Mark Heacock is a smoker living in Louisiana.

Petitioners were the plaintiffs in the district court and the appellants in the Fifth Circuit.

None of the petitioners is publicly traded or owned in whole or in part by any publicly traded corporation.

Respondent James D. "Buddy" Caldwell is the Attorney General of the State of Louisiana, being sued in his official capacity. Respondent was the defendant in the district court and the appellee in the Fifth Circuit.

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PETITION FOR WRIT OF CERTIORARI

Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the District Court for the Western District of Louisiana granting defendant summary judgment is unpublished and is attached at Appendix B1-B22. The decision of the Fifth Circuit affirming the district court decision is published at 614 F.3d 172 and is attached at Appendix A1-A14.

JURISDICTION

The Fifth Circuit issued its decision on August 10, 2010. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1). The district court had jurisdiction under 28 U.S.C. § 1331.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Sherman Act, 15 U.S.C. § 1, provides, in relevant part:

> Every contract, combination * * *, or conspiracy, in restraint of trade or commerce among the several States * * * is declared to be illegal.

The Compact Clause, U.S. CONST., Art. I, § 10, cl. 3, provides, in relevant part:

> No State shall, without the Consent of Congress, * * * enter into any Agreement or Compact with another State, or with a foreign power."

STATEMENT OF THE CASE

During the 1990s, Attorneys General in many States, including Louisiana, sued the four largest tobacco companies (the "Majors") to recoup Medicaid expenses allegedly incurred as a result of fraudulent sales techniques. The tobacco companies drafted a settlement that would enrich themselves as well as the States. Rather than base damages on retrospective losses caused by each tobacco company, the parties agreed to divide payment responsibility based on each company's future market share. The anticipated payments totaled more than $200 billion over the succeeding 25 years, with further payments in perpetuity. Because these payments would place the settling companies at a competitive disadvantage with other manufacturers, the Master Settlement Agreement ("MSA") required the 46 settling States to impose countervailing escrow payments on all nonparticipating tobacco manufacturers, and to insulate the settling companies from competition in a variety of ways described below. The MSA also contained various provisions to prevent its member States from defecting from this nationwide scheme.

As a result of this agreement, the participating States have reaped billions of dollars in revenues each year from duties on tobacco sales without enacting taxes, and the large tobacco companies have been able to increase their prices by an even greater amount – all at the expense of consumers and competition. The States could not have attained this result acting individually because of the force of interstate competition. The tobacco companies could not have attained this result acting without the States because

it would have too blatantly violated the antitrust laws. Only through the binding and irrevocable MSA have they been able to achieve such a result. And, to insulate and preserve this regime from future political pressure, the agreement forbids the signatories to oppose the MSA in the future or even to speak or petition against it.

This lawsuit was filed by a small non-settling tobacco company, a consumer, and a tobacco shop. The plaintiffs contend that the MSA violates the antitrust laws and, because it was not approved by Congress, the Compact Clause of Article I, § 10. The court of appeals held that the agreement is immune from antitrust scrutiny under the state-action immunity doctrine of *Parker* v. *Brown*, 317 U.S. 341 (1943), and falls outside the scope of the Compact Clause because it does not directly conflict with any federal law or other constitutional constraint.

Those holdings, we submit, conflict with this Court's decisions and do grave damage to principles of interstate federalism and competition. Because of the unusual conjunction of interests of the States and the large tobacco companies in sharing the rents generated by the MSA's suppression of competition, and because of the irrevocable and unchallengeable character of the agreement, there is little prospect for effective public debate or legislative scrutiny unless this Court intervenes.

1. In 1998, 46 Attorneys General and the Majors settled numerous lawsuits brought by many States against the Majors by collectively entering into the MSA.

The MSA, which was devised and drafted by the tobacco companies, contained something for almost everyone. For the States, the agreement provided that the Majors and certain other cigarette manufacturers who later joined the MSA would pay more than $200 billion over 25 years, plus other payments in perpetuity. MSA § IX.[1]

For the tobacco companies, in addition to securing them a release from past and potential future liability, the MSA set up an interstate cartel enabling them to charge monopoly prices and recover their MSA costs, plus hefty additional profits, from consumers without fear of price competition among themselves or from non-participating cigarette manufacturers.

2. The MSA establishes this cartel through a variety of restrictions on interstate commerce in cigarettes.

First, the agreement discourages price competition for market share by allocating the costs of the MSA among the Majors in proportion to their *current* national market share of cigarette sales, including sales in States that have not joined the MSA. MSA § IX(c)(1). The percentage of MSA payments by each of the four Majors thus annually rises or falls in relation to its national market share, thereby discouraging price competition for gains in market share that would increase MSA expenses and reduce profits. That disincentive also encourages each company to match price increases by competitors, even beyond those necessary to pass on MSA expenses, in order to

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[1] The lengthy MSA is available in PDF form at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf.

avoid increased market share (and MSA expenses) that would result from lower relative prices.

Second, the agreement discourages price competition and divides the market among subsequent participating manufacturers ("SPMs") that joined within 90 days by exempting them from MSA payments on all sales at or below their "grandfathered" market shares – the higher of their 1998 sales, or 125% of their 1997 sales. MSA § IX(i). SPMs exceeding their grandfathered market shares are penalized by having to make MSA payments on excess sales.

Third, the agreement stabilizes prices and limits price competition from all other manufacturers joining the MSA after 90 days by imposing annual MSA payments on those manufactures based on their entire national market share. *Id.* The per-cigarette payments by such late-joining SPMs are larger than the per-cigarette MSA payments by the Majors, thereby raising the floor on prices such companies can charge and still recover their costs.

Fourth, the agreement restrains competition among all participating manufacturers by forbidding numerous forms of advertising, as well as lobbying and litigation adverse to the MSA. MSA §§ III(b)-(i), III(m)-(p), XVIII(*l*). Many of those restrictions apply nationwide, not merely within the MSA States. *Id.* §§ II(rr), III(b)-(c).

Fifth, the agreement stabilizes prices and limits price competition from non-participating cigarette manufacturers ("NPMs") that refuse to join the MSA by requiring member States to enact so-called "Qualifying" or "Escrow" statutes compelling NPMs to pay into escrow each year an amount equal to or greater

than the MSA payments on comparable sales. MSA § IX(d)(2)(E); MSA Exh. T.

The MSA's Escrow Statute requirement has the express purpose of "effectively and fully neutraliz[ing] the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of" the MSA. MSA § IX(d)(2)(E); LA. R.S. § 13:5061 (6) (Escrow Statute designed to prevent NPMs from having a "resulting cost advantage").

Absent the Escrow Statutes, smaller tobacco companies that had neither engaged in nor been sued for fraud – and hence had no liabilities to settle – would have had substantially lower per-cigarette costs than companies having to make MSA payments. The Majors and other participating manufacturers thus faced a competitive dilemma: If they raised prices to pass MSA costs on to consumers they risked losing market share to NPMs without such expenses; but if they kept their prices competitive their MSA payments would have eaten into their profits.

The Escrow Statutes raise the costs for NPMs and thereby stabilize prices at or above the level necessary to allow MSA participants to pass their MSA costs on to consumers without risk of price competition from NPMs.

Indeed, the MSA's restrictions on price competition have actually allowed the Majors to raise prices by far more than the amount necessary to make MSA

payments.[2] Thus, after joining the MSA, the major cigarette manufacturers have made record profits from their supra-competitive pricing.[3]

3. The MSA also contains various provisions to prevent member States from defecting from their supporting role in the cartel.

First, the MSA restrains the political and legislative processes of its member States by binding "present and future" state officials, and forbidding States to withdraw from or "directly or indirectly" challenge the MSA. MSA §§ XVIII(g), (*l*). The agreement may not be modified without the unanimous consent of the parties affected. *Id.* § XVIII(j). The ordinary political and legal processes that might mitigate state-imposed or supported restraints on trade thus are rendered inoperative. Future state officials cannot withdraw from, and hence cannot be held accountable for, their participation in the MSA.

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[2] *Final Submission of the Settling States: Expert Report of Jonathan Gruber & Robert S. Pindyck* at 2-3 (Jan. 30, 2006) ("*Gruber & Pindyck Final Sub.*") ("Between 1997 and 2003, OPM premium and discount retail prices increased by much more than MSA marginal costs") [Sealed Doc. 96, attach. 5]; *Report of Plaintiffs' Expert Jeremy Bulow* at 3 (Aug. 13, 2008) ("*Bulow Rep.*") ("the major companies have raised the price of cigarettes by considerably more than the cost of the MSA, or by the amount of any cost increases. Experts for the major companies have acknowledged that the MSA created incentives to raise prices by more than costs increased") [Record on Appeal ("R") R1087].

[3] Mark Curriden, *Up In Smoke*, ABA JOURNAL (March 2007) at 30 (Philip Morris profits "were $4.5 billion in 2005—up 36 percent from 1997," while its stock price doubled).

Second, the MSA requires each State to adopt and diligently enforce the Escrow Statute set out in the MSA in a manner that "effectively and fully neutralizes" the competitive consequences for companies joining the MSA. MSA § IX(d)(2)(E). Failure to do so subjects non-compliant States to the severe financial penalty of having their payments reduced by the so-called "NPM Adjustment," which reduces the MSA fees paid by companies that lose market share as a result of the MSA. MSA §§ II(ff), IX(d).

All determinations regarding the size and allocation among the States of the NPM adjustment are delegated to a private group of economic consultants (dubbed "the Firm") selected by the Majors and the executive committee of the National Association of Attorneys General. MSA § IX(d)(1)(C). Determinations by the Firm are "conclusive and binding," "final and non-appealable." *Id.*

Non-compliant States thus could forfeit much of their share of payments on nationwide cigarette sales, at the cost of billions of dollars, while leaving their citizens to pay the remaining passed-through MSA costs on all cigarette sales in that State. Such potential penalties imposed "coercive" pressure on the member States to adopt and enforce the Escrow Statute, and all did. *Star Scientific Inc.* v. *Beales*, 278 F.3d 339, 359 (CA4) ("Because Virginia could face a substantial financial burden if it were not to enact a qualifying statute, the [MSA] is coercive in requiring the states to pass such a statute"), *cert. denied*, 537 U.S. 818 (2002). Louisiana state legislators cited

such penalties and pressure to justify passing the State's Escrow Statute.[4]

Third, the MSA constrains the sovereignty of its member States by allowing some States to extract revenues from cigarette sales in other States. It does so by freezing the share of MSA payments distributed to each State as of the date of the agreement, while the share of MSA payments passed on to each State's consumers rises or falls with changes in sales within each State. MSA §§ IX(c)(1), IX(j); MSA Exh. A. This renders some States net exporters and other States net importers of MSA revenues.

Fourth, the MSA encroaches upon the sovereignty of the four non-member States by requiring the tobacco companies to make payments based on their *national* market share of cigarette sales, including sales to consumers in non-member States. MSA § IX(c)(1). The MSA also restricts tobacco companies' advertising, lobbying, and litigation throughout the nation, forbidding many such activities even in non-member States. *See, e.g.*, MSA § II(rr) (definition of "State" to mean "any state of the United States" and various territories); *id.* § III(b)-(c) (ban on use of cartoons; restrictions on "Brand Name Sponsorship in any State"); *id.* § III(m) (prohibition on manufacturers supporting, "in Congress or any other forum," leg-

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[4] *Stipulated transcript of portions of hearing in Louisiana House of Representatives* (April 8, 1999), at 6, and of *Chamber Proceedings in Louisiana House of Representatives* (April 15, 1999), at 7-9 & 12-13 (statements of Louisiana legislators and Louisiana's Attorney General noting that the State had no choice but to enact the MSA's Qualifying Statute word-for-word) [R1072, R1077-79, R1082-83].

islation or rules "that would preempt, override, abrogate, or diminish" the member States' rights under the MSA). The MSA thus purports to regulate tobacco company behavior in Florida, Texas, Minnesota and Mississippi, even though those States are not parties to the agreement.

4. Given the national scope of the restrictions and their direct operation on interstate commerce, the States and the Majors initially sought to have Congress legislatively implement and provide enforcement for a precursor to the MSA proposed by the tobacco companies and various States.[5] That proposal was similar to the MSA in most relevant respects. After the Federal Trade Commission warned of its anticompetitive character, the proposal died in the Senate. 144 CONG. REC. S6479-S6481 (June 17, 1998).[6] Undeterred, the Majors and the participating

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[5] Philip Morris Companies, Inc., SEC Form 8-K Current Report, June 20, 1997 (reporting proposed settlement), available at http://www.sec.gov/Archives/edgar/data/764180/0000940180-97-000570.txt.

[6] *See* FTC, *Competition and the Financial Impact of the Proposed Tobacco Settlement* (September 1997) ("From an antitrust and economic perspective, a proposal that Congress enact a statute enabling private firms to agree to raise prices to pay past liabilities should be viewed with caution."; "there is reason to believe that cigarette prices will increase by more than is necessary simply to 'pass through' the annual payments to consumers"; "restrictions on marketing could raise barriers to entry and expansion and ultimately lead to higher prices"; provision requiring escrow payments for non-participating manufacturers "could have a disproportionate effect on the small firms at the fringe of the market as well as potential entrants * * * and may make it less likely they can effectively compete in the market"), available at www.ftc.gov/reports/tobacco/tobacco9909.shtm;

States adopted the MSA as a private agreement, without congressional involvement or approval.

5. On August 2, 2005, plaintiffs brought suit against Respondent Louisiana Attorney General Caldwell's predecessor, in his official capacity, seeking a declaratory judgment and an injunction against enforcement of the MSA and its Louisiana implementing statutes.

Plaintiffs alleged, *inter alia*, that the MSA, in conjunction with its implementing statutes, (1) constitutes an illegal agreement in restraint of trade that creates a national cartel to divide markets, suppress competition, and raise prices, in violation of federal antitrust laws, and (2) constitutes an interstate agreement, unapproved by Congress, that potentially and actually encroaches upon federal authority and upon the independent sovereign interests of both member and non-member States, in violation of the Compact Clause.[7]

6. On November 9, 2006, the district court denied defendant's motion to dismiss, except as to one claim that is no longer at issue in this case. [R9, docket entry 48]

7. On September 24, 2009, the district court denied plaintiffs' motions for summary judgment on

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Freedom Holdings v. *Spitzer*, 357 F.3d 205, 229 n.23, 230 (CA2 2004) (quoting objections from FTC Chairman Robert Pitofsky).

[7] Plaintiffs also raised claims that the MSA and its implementing legislation violated the First Amendment, conflicted with the Federal Cigarette Labeling and Advertising Act, 15 U.S.C. § 1334, violated the Commerce and Due Process Clauses, and violated the Tenth Amendment.

their remaining claims and granted defendant's motion for summary judgment as to those claims. App. B1-B22.

8. On August 20, 2010, the Fifth Circuit affirmed. App. A1-A14.

Regarding the antitrust claim, the court did not dispute the unchallenged proposition that the MSA itself was an agreement in restraint of trade and a *per se* violation of the Sherman Act. Rather, it addressed only whether defendant was entitled to invoke "state-action" immunity as originally set forth in this Court's decision in *Parker* v. *Brown*, 317 U.S. 341 (1943).

Plaintiffs argued that *Parker* was inapplicable to the MSA. In *Parker*, this Court explained that state-action immunity would not extend to cases where the State acts as a "participant in a private agreement or combination by others for restraint of trade," or seeks to "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." 317 U.S. at 351-52.

The Fifth Circuit provided almost no independent analysis of this issue, relying instead on two prior cases that rejected challenges to individual state Escrow Statutes, rather than the MSA itself. App. A8-A9 (quoting *Xcaliber Int'l Ltd. LLC* v. *Caldwell*, 612 F.3d 368, 375 (CA5 2010) and *Tritent International Corp.* v. *Kentucky*, 467 F.3d 547, 557 (CA6 2006)). Viewed in isolation from the MSA, the Escrow Statutes arguably fall within the antitrust immunity doctrine of *Parker* because they are single-state statutes with only intrastate application that do not themselves require agreements or conduct illegal un-

der the antitrust laws. The MSA, by contrast, is an agreement among 46 States and numerous private companies, directly restrains trade and divides markets among its private participants, and has nationwide operation and economic effects. The Fifth Circuit did not explain how such an agreement could be entitled to antitrust immunity under *Parker*.[8]

Regarding the Compact Clause claim, the court of appeals relied upon this Court's decision in *United States Steel Corp.* v. *Multistate Tax Commission*, 434 U.S. 452 (1978) ("*MTC*"), and upon the Fourth Circuit's decision in *Star Scientific, Inc.* v. *Beales*, 278 F.3d 339 (CA4), *cert. denied*, 537 U.S. 818 (2002), for the proposition that the Compact Clause only applies to agreements that " 'enhance[] state power *quoad* the National Government.' " App. A6 (quoting *MTC*, 434 U.S. at 473). Quoting the Fourth Circuit, the court then held that

> "the [MSA] may result in an increase in bargaining power of the States *vis-a-vis* the tobacco manufacturers, but this increase in power does not interfere with federal supremacy be-

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[8] The court also cited, without discussion, two other appellate decisions involving the MSA. *Grand River Enters. Six Nations, Ltd.* v. *Beebe*, 574 F.3d 929 (CA8 2009), *cert. denied*, 130 S. Ct. 2095 (2010); *Sanders* v. *Brown*, 504 F.3d 903 (CA9 2007), *cert. denied*, 553 U.S. 1031 (2008). App. A8-A9. Although both decisions contain dictum to the effect that the MSA was entitled to antitrust immunity, that issue was not actually presented in either case. *Grand River* involved a challenge only to an amendment to the Arkansas Escrow Statute. 574 F.3d at 932. *Sanders* addressed a challenge to post-MSA conduct, noting that the plaintiff "does not allege that the MSA itself is illegal." 504 F.3d at 906.

> cause the [MSA] 'does not purport to authorize the member States to exercise any powers they could not exercise in its absence.' "

App. A7 (quoting 278 F.3d at 360, in turn quoting *MTC*, 434 U.S. at 473). That holding effectively limited the Compact Clause to agreements to engage in conduct that would otherwise be illegal or unconstitutional for individual States.

In restricting the Compact Clause to such a narrow and unnecessary category of agreements, the court below effectively eliminated two other categories of agreements identified by this Court as being subject to the Compact Clause – those that have the *potential* for encroaching on federal authority and those that potentially or actually encroach on sister-State sovereignty. *MTC*, 434 U.S. at 472 (agreements with "potential" for encroachment); *Florida* v. *Georgia*, 58 U.S. 478, 494 (1855) (agreements that "might affect injuriously the interest of the other[]" States). The Fifth Circuit simply ignored how the MSA fit within these other categories, thus stripping the Compact Clause and this Court's cases of virtually all independent function and effect.

REASONS FOR GRANTING THE WRIT

The MSA is an unprecedented multistate and multi-company agreement that restrains trade in and stifles competition for hundreds of billions of dollars of interstate commerce, extracts billions of dollars in supra-competitive profits from consumers, and perverts core federalism principles. It establishes both a nationwide cartel among tobacco manufacturers and a nationwide economic confederacy among numerous

States without the congressional consent required by the Compact Clause.

The MSA is as undemocratic as it is anticompetitive. Congress and the state legislatures have ample authority to tax and regulate tobacco. But this should be done the old-fashioned way: by passing taxes and restrictions subject to the democratic scrutiny of the people – not by enforcing sweetheart deals drafted by industry, imposed on the entire nation without congressional involvement, and carefully insulated against repeal or democratic review.

Unfortunately, the MSA has escaped judicial as well as democratic scrutiny, by virtue of strained interpretations of antitrust immunity and Compact Clause limitations that ignore the important limits this Court has placed on those doctrines. The sheer magnitude of the private and governmental interests backing the MSA – contrasted with the relative powerlessness of the consumers and small companies injured by it – has seemingly discouraged the serious and searching judicial scrutiny one would expect of an agreement of such economic and political importance. Forty-six of the States reap billions of dollars every year as a result of the MSA, and the tobacco industry giants reap billions more. It seems too good to be true – unless you are a consumer or a small company trying to compete with the Majors and other participating manufacturers. Yet as the decision below illustrates, the courts have given a perfunctory back of the hand to challenges to the MSA. Without careful analysis or explanation, immunities have been stretched far beyond their proper scope and the Compact Clause has been rendered a redundancy.

Only this Court can bring about the judicial and congressional scrutiny required by the Sherman Act and the Constitution.

I. This Court Should Decide Whether *Parker* State-Action Immunity Should be Extended to Agreements Among Multiple States and Private Companies in Restraint of Nationwide Commerce.

As described above, at 4-10, the MSA is a collective agreement between multiple tobacco companies and numerous States that, *inter alia*, divides markets, penalizes price competition, stabilizes prices, and restricts advertising. Such an agreement is illegal under the plain and express terms of the Sherman Act, which provides that "[e]very contract, combination * * *, or conspiracy, in restraint of trade or commerce among the several States * * * is declared to be illegal." 15 U.S.C. § 1.

It is undisputed that were the MSA solely an agreement between private parties, it would be *per se* illegal.[9] Indeed, in *Freedom Holdings*, 357 F.3d at

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[9] This Court's cases firmly establish that combinations and conspiracies establishing cartels, dividing markets, and fixing prices are quintessential *per se* antitrust violations. *City of Lafayette* v. *Louisiana Power & Light Co.*, 435 U.S. 389, 406-07 (1978) (cartels); *Catalano, Inc.* v. *Target Sales, Inc.*, 446 U.S. 643, 647-49 (1980) ("combination formed for the purpose of raising * * * or stabilizing the price of a commodity"); *United States* v. *Topco Assocs.*, 405 U.S. 596 (1972) (horizontal market division); *see also Blackburn* v. *Sweeney*, 53 F.3d 825, 828 (CA7 1995) (agreements among competitors restricting advertising violate Sherman Act); *National Electrical Contractors Ass'n* v. *National Constructors Ass'n*, 678 F.2d 492, 497 (CA4 1982) (agreement between union and contractors to impose costs on some

225, the Second Circuit recognized that because "the MSA" is an "express market sharing agreement, * * * [h]ad the executives of the major tobacco companies entered into such an arrangement without the involvement of the States and their attorneys general, those executives would long ago have had depressing conversations with their attorneys about the United States Sentencing Guidelines."

The Fifth Circuit's sole basis for declining to apply the Sherman Act to the MSA was the state-action immunity defense originally articulated by this Court in *Parker* v. *Brown*. App. A7-A10.

In *Parker*, this Court, relying on principles of federalism and state sovereignty, declined to "lightly" attribute to Congress, in enacting the Sherman Act, an intention to "restrain a state or its officers or agents from activities directed by its legislature." *Id.* at 350-51. Reviewing a California marketing statute that restricted competition among raisin growers, this Court observed that a State was presumptively free to direct its officers and agents to regulate its own markets. *Id.*; *see id.* at 359-60 (the "governments of the states are sovereign within their territory").

Absent any specifically expressed congressional intent to limit state legislative activity, and finding that the State "as sovereign" had "imposed the restraint as an act of government" rather than by making an "agreement or contract" or by entering into a "conspiracy in restraint of trade," this Court held that

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competitors to compensate for costs voluntarily assumed by other competitors is a *per se* illegal attempt to "stabilize prices").

the state program at issue was not prohibited by the Sherman Act. *Id.* at 352.

This Court included the proviso, however, that even state action will not avoid the prohibitions of the Sherman Act if the State acts as a "participant in a private agreement or combination by others for restraint of trade," or seeks to "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Id.* at 351-52.

The Fifth Circuit below relied upon the *Parker* state-action doctrine to find the MSA immune from the Sherman Act. Erroneously adopting the Sixth Circuit's reasoning rejecting a challenge to Kentucky's Escrow Statute, rather than to the MSA as a whole, the court discussed only the indirect effects of the *statute* on price competition. Observing that diminished price competition was " 'neither mandated nor specifically authorized by the State,' " the court held that the Escrow Statute was entitled to state-action immunity. App. A9 (quoting *Tritent*, 467 F.3d at 557).

The Sixth Circuit's analysis of whether the Escrow Statute alone compels or authorizes subsequent illegal activity is largely beside the point. The question in this case is whether, by joining and condoning an admittedly *per se* illegal agreement between private parties, Louisiana and other States have conferred *Parker* immunity on the MSA. Under the express limits of the *Parker* decision and its fundamental rationale, state-action immunity does not apply to the MSA.

First, *Parker* specifically distinguished between the imposition by a single State of a "restraint [on trade] as an act of government," which is presumed immune from the antitrust laws, and conduct by a State that constitutes an "agreement or contract" or a "conspiracy" with private parties, which remains subject to antitrust scrutiny. 317 U.S. at 352 *Parker* was quite explicit in excluding from immunity those cases where the State acts as a "participant in a private agreement or combination by others for restraint of trade" or seeks to "authoriz[e]" such an agreement, *id.* at 351-52, and that exclusion squarely applies to the MSA.[10]

Second, the *Parker* doctrine only shields regulations within individual States, not national cartels like the MSA. *See Northern Securities Co.* v. *United States*, 193 U.S. 197, 346 (1904) (State may not "give a corporation * * * authority to restrain interstate or international commerce"). This Court has never applied *Parker* outside the single-state context, and certainly not to a multistate and multi-competitor agreement restricting nationwide interstate commerce. The very premise of *Parker* was that federalism and state sovereignty provided some presumptive protection to State conduct within a State's limited sphere of sovereignty – and required an express statement of congressional intent to overcome that presumptive sovereignty. *Parker*, 317 U.S. at 350; *cf. id.* at 359-60 (emphasizing, in discussing the related

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[10] Furthermore, the decision by Louisiana's Attorney General to enter into the MSA was not conduct "directed by its legislature," as described in *Parker*. 317 U.S. at 350-51. The MSA preceded any state legislation.

Commerce Clause challenge, that "states are sovereign within their territory save only as they are subject to the prohibitions of the Constitution," or conflict with national powers or legislation).

The decision below turns *Parker*'s premises and presumptions on their heads. Rather than making independent choices regarding matters wholly "within their territory," the MSA States have acted *collectively*, via agreements with private industry, to divide markets, raise prices, and restrict advertising nationwide, even in the four non-MSA States. *Supra* at 4. Far from being legislation internal to each State, the MSA virtually compelled state participation by imposing costs on consumers in all 50 States, while distributing benefits only to those state governments that joined the agreement. Such collective, coercive, and extraterritorial regulation flies in the face of the federalism interests animating *Parker*. *See Lafayette*, 435 U.S. at 406-07 (conduct's extraterritorial reach, involving buyers outside the defendant city, militated against granting immunity).

Third, the federalism virtues of local control and political accountability – thought by this Court to mitigate any potential consequences of individual state choices to restrict competition – have no application to the MSA, which has collectivized the decision-making of the States and removed *both* local control and political accountability. *Cf. Hallie* v. *Eau Claire*, 471 U.S. 34, 45 n.9 (1985) (distinguishing municipal from private anticompetitive conduct permitted by State because "the electoral process * * * may provide some greater protection against antitrust abuses than exists for private parties").

As noted above, at 9 n.4, Louisiana legislators acknowledged during debate over passage of the qualifying Escrow Statute that they had no choice but to enact it word for word. Moreover, having joined the MSA, they may not withdraw from it, have no recourse regarding the decisions of the Firm, and are forbidden from challenging the MSA in virtually any way. *Supra* at 7-8. Individual States may not alter the MSA without the unanimous consent of the other affected parties, MSA § XVIII(j). States are therefore forbidden to adapt their law to local conditions or to respond to local political pressures. The people of Louisiana cannot bring about democratic change via elections because the Attorney General who signed the MSA bound all future state officials in perpetuity. MSA § XVIII(g). Contrary to the democratic premises of *Parker*, the citizens of States that are part of the MSA have no means, either through the "electoral process" or "public scrutiny," of holding their officials accountable on matters governed by the MSA. *Hallie*, 471 U.S. at 45 n.9. And, of course, the four non-MSA States and their citizens have no say whatsoever over the behavior of the MSA States. *See Lafayette*, 435 U.S. at 406 ("consumers living outside the municipality * * * have no recourse at the municipal level").

Fourth, even *Parker*'s basic premises of reserved state sovereignty, limited federal power, and the presumed congressional reluctance to interfere with state prerogatives do not apply to an *agreement* between States as opposed to independent state action. As explained in the following section, the Compact Clause expressly limits state authority to enter into certain agreements with other States, requires affir-

mative congressional approval for such agreements, and consequently reverses the ordinary federalism presumptions and permissive default rule applied in challenges to individual state action.

Finally, because "state action immunity is disfavored, much as are repeals by implication," *FTC* v. *Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992), it should not be extended to cover an agreement imposing extraterritorial regulation of national scope, like the MSA. Unlike in *Parker*, the relevant implications from the Constitution's terms and structure cut in *favor* of enforcing the Sherman Act strictly against multistate agreements in restraint of trade, and thus there is no justification for judicially narrowing the plain terms of the Sherman Act.

II. The Decision Below Strips the Compact Clause of All Independent Meaning.

In addition to being an agreement among competitors, joined by the States, the MSA also is an agreement between and among the member States themselves, falling within the express terms of the Compact Clause. That Clause provides that "[n]o state shall, without the Consent of Congress, * * * enter into any Agreement or Compact with another State, or with a foreign power." U.S. CONST., Art. I, § 10, cl. 3.

In constructing our system of federalism, the Framers were sensitive not only to the need to limit the national government and preserve state sovereignty, but also to the dangers posed by competing combinations of States with each other or with foreign nations. Such combinations threatened to interfere

with the careful balance of state independence and national collective action contemplated by the Constitution. To avoid those dangers, the Constitution strictly forbade States to "enter into any Treaty, Alliance, or Confederation" and required congressional consent for any state "Agreement or Compact" with other States or with foreign nations. U.S. CONST., Art. I, § 10, cl. 1 & 3.

As this Court has recognized, the purpose of that latter restriction, the Compact Clause, is "to guard against the derangement of [compacting States'] federal relations with other States of the Union, and the federal government; which might be injuriously affected." *Rhode Island* v. *Massachusetts*, 37 U.S. 657, 726 (1838). It achieves this purpose by "ensur[ing] that whatever sovereignty a State possesses within its own sphere of authority ends at its political border." *Port Authority Trans-Hudson Corp.* v. *Feeney*, 495 U.S. 299, 315 (1990).

In order to prevent the Compact Clause from overstepping its purpose, this Court has observed that it should not be read too literally to encompass *every* possible agreement between States, lest it cover agreements "to which the United States can have no possible objection or have any interest in interfering with." *Virginia* v. *Tennessee*, 148 U.S. 503, 518 (1883). There nonetheless remains a sizeable category of interstate agreements that *are* objectionable or of interest to the United States.

Some agreements – those of an overtly political character – are absolutely prohibited by the Treaty

Clause of Article I. U.S. CONST., Art I, § 10, cl. 1.[11] Other agreements, involving " 'what might be deemed mere private rights of sovereignty; such as questions of boundary, interests in land situate in the territory of each other, and other internal regulations for the mutual comfort and convenience of states bordering on each other' " are permissible only with the consent of Congress. 148 U.S. at 519 (quoting J. Story, *Commentaries* § 1403).

This Court's cases have identified three basic qualities of agreements that are subject to the Compact Clause:

- The Compact Clause applies to *binding* agreements between States, not mere coordination, voluntary cooperation, or reciprocity. *Virginia* v. *Tennessee*, 148 U.S. at 520-21 ("Compacts or agreements * * * cover all stipulations affecting the conduct or claims of the parties"; "no compact or agreement between the states in this case * * * until they had * * * mutually declared the boundary established by them to be the true and real boundary between the states," each "in consideration of the ratification of the other").

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[11] *Virginia* v. *Tennessee*, 148 U.S. at 519 (Treaty Clause prohibits agreements of a political character " 'in which the parties are leagued for mutual government, political co-operation, and the exercise of political sovereignty, and treaties of cession of sovereignty, or conferring internal political jurisdiction, or external political dependence, or general commercial privileges' ") (quoting J. Story, *Commentaries* § 1403).

- The Compact Clause applies to agreements that "*may* lead * * * to the increase of the political power or influence of the states affected, and thus encroach * * * upon the full and free exercise of federal authority." *Id.* at 520 (emphasis added).

- The Compact Clause applies to agreements that "*might* affect injuriously the interest of the other[]" States, *Florida* v. *Georgia*, 58 U.S. at 494 (emphasis added).

Over the years a variety of interstate compacts have been submitted to Congress, and Congress has not hesitated to impose conditions on its approval in order to protect federal interests. *See* Michael Greve, *Compacts, Cartels, and Congressional Consent*, 68 Mo. L. Rev. 285, 288-89, 326-28 (2003) (over 200 interstate compacts on numerous subjects, including environmental and energy policy, crime control, education, and limits on competition regarding commodities or natural resources; imposition of periodic reapproval requirements for dairy and oil and gas compacts).

In the leading modern case on the Compact Clause, *United States Steel Corp.* v. *Multistate Tax Commission*, this Court endorsed its earlier observations in *Virginia* v. *Tennessee*, and used them to evaluate a voluntary agreement among various States designed to coordinate taxation of business income earned in multiple States. Recognizing the underlying purposes of the Compact Clause, this Court agreed that the "pertinent inquiry is one of *potential*, rather than actual, impact upon federal supremacy."

434 U.S. at 472 (emphasis added). Even so, it concluded that the benign character of the agreement placed it outside the concerns of the Compact Clause.

Unlike the MSA – or the binding agreement in *Virginia* v. *Tennessee* – the agreement in *MTC* was not binding, but was wholly voluntary and States could (and did) withdraw unilaterally at any time. *Id.* at 454 n.1, 457. Given the exit threat, the voluntary coordination provided in *MTC* posed no danger of hindering the independence of and competition among the States. The agreement in *MTC* involved no "delegation of sovereign power" from the States and each participating State retained "complete control over all legislation and administrative action" regarding taxes, and the authority "to reject, disregard, amend or modify any rules" of the Commission without penalty, "just as it could if the compact did not exist." *Id.* at 473, 477-78.

Unlike the MSA's restrictions on trade in the national tobacco market, its extraterritorial fees and prohibitions, and its restrictions on speech, nothing in the *MTC* agreement even "touche[d] upon constitutional strictures." *Id.* at 478. Indeed, the agreement in *MTC* actually provided voluntary coordination in *furtherance* of avoiding constitutional and federal concerns regarding multiple taxation of interstate businesses. *Id.* at 455-56. The agreement thus did not even potentially encroach upon federal authority.

And, unlike the nationwide fees, structured payments, and fixed distributions under the MSA, there was nothing in the *MTC* agreement that would "redound to the benefit of any particular group of States or to the harm of others." *Id.* at 477.

Given the limited and innocuous scope of the agreement in *MTC*, this Court concluded that it posed no threat to federal authority or state rights and interests and consequently was not subject to the Compact Clause.

In rejecting application of the Compact Clause to the MSA, the Fifth Circuit in the present case adopted an unreasonably narrow construction that ignored the holding and lessons of *MTC* and rendered the Clause redundant with the Supremacy Clause. App. A5-A7. Offering no analysis of its own, the court below adopted the cursory reasoning of the Fourth Circuit in *Star Scientific*, which found no encroachment upon federal authority because the MSA did not authorize conduct otherwise forbidden to the States individually and because the MSA acknowledged the primacy of federal law in the event of any conflict. 278 F.3d at 359-60. Neither *Star Scientific* nor the court below addressed the significant differences between the MSA and the agreement in *MTC*, and neither court engaged in the "pertinent inquiry" whether the MSA involves "potential, rather than actual, encroachment." *MTC*, 434 U.S. at 472.

Both the court below and the Fourth Circuit were wrong in their construction of the Compact Clause and in upholding the MSA pursuant to that overly narrow construction. The MSA is a binding agreement among numerous States that, at a minimum, potentially encroaches on federal sovereignty and sister-state authority and interests.

A. The MSA Is a Binding Agreement Among Its Member States.

As noted above, *supra* at 7-9, 26, the MSA goes well beyond the mere voluntary coordination in *MTC* and imposes binding and perpetual obligations on the States, controls "the conduct [and] claims of the parties, *Virginia* v. *Tennessee*, 148 U.S. at 520, and penalizes non-compliance. The MSA is, in fact, the polar opposite of the agreement in *MTC* in this constitutionally critical dimension. It effectively coerced States into joining and severely constrains their behavior such that they are not free to act "just as [they] could if the compact did not exist." *MTC*, 434 U.S. at 477-78.

B. The MSA Potentially and Actually Encroaches upon Federal Supremacy.

As emphasized by this Court in *MTC*, the Compact Clause protects against even "potential" encroachments on federal sovereignty, not merely against actual conflicts.

The court below and the Fourth Circuit, however, narrowed their Compact Clause analysis to whether the MSA purported to authorize its member-States "to exercise any powers they could not exercise" individually. App. A7; *Star Scientific*, 278 F.3d at 360; *see also id.* (MSA "does not derogate from the power of the federal government" because it acknowledges the supremacy of current or future conflicting federal legislation). But the only "powers" individual States may not exercise are those actually preempted by federal law or forbidden them by the Constitution. If the test for applying the Compact Clause is solely

whether an agreement purports to authorize conduct otherwise preempted or unconstitutional as to individual States, then this Court's distinction between potential and actual encroachment on federal supremacy is eliminated and the Compact Clause is rendered entirely redundant. Such a narrow construction of the Clause would have no operation beyond situations already covered by the Supremacy Clause, the Commerce Clause, or other constitutional limits on state action. "It cannot be presumed," however, "that any clause in the constitution is intended to be without effect." *Marbury* v. *Madison*, 5 U.S. 137, 174 (1803). [12]

A focus on potential, rather than actual, encroachment provides the necessary independent effect to the Compact Clause. States acting individually have the power to legislate in ways that potentially conflict with federal supremacy, so long as state law does not actually conflict with such supremacy. In close or ambiguous cases, courts apply a default rule – based on federalism principles of state sovereignty and limited national powers – that operates to sustain state laws absent an actual and "irreconcilable conflict * * *. The existence of a hypothetical or potential conflict is insufficient." *Rice* v. *Norman Williams Co.*, 458 U.S. 654, 659 (1982). But for *agreements* between States, the Compact Clause and this Court's cases reverse the default rule: agreements to

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[12] Were that a correct reading of *MTC* – though it is not – it would make *MTC* an inappropriate and "[in]effective alternative" to "a literal reading of the Compact Clause," *MTC*, 434 U.S. at 460, and call for this Court to modify or overrule *MTC* in order to provide some meaning for the Compact Clause.

engage in conduct having precisely the same "potential" for conflict are invalid absent congressional consent. That *prophylactic* default rule protects federal prerogatives regarding interstate agreements and places the risk of "false negatives" in ambiguous cases on the States rather than on Congress. *See* Greve, 68 Mo. L. Rev. at 317 (usual presumption under the Supremacy or dormant Commerce Clause "will produce a number of 'false negatives' – that is, unaddressed offenses against national rights and prerogatives," with Congress bearing the burden to correct such results). [13]

Under a proper reading of the Compact Clause, the MSA is invalid absent congressional consent because it raises no lack of potential conflicts with federal supremacy:

- As the debate in Congress over the proposed legislative precursor to the MSA shows, *see supra* at 10, the MSA has at least the potential to encroach upon federal authority concerning interstate competition and antitrust law. The Federal Trade Commission issued a report warning that the proposed legislation, which was comparable to the MSA in relevant respects, could "raise barriers to entry and

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[13] Applying the Compact Clause's restrictive default rule to interstate agreements, rather than the permissive default rule applied to individual state statutes, does not undermine principles of judicial restraint. Rather, the Compact Clause rule eliminates the need for judicial speculation regarding congressional intent in cases of potential or uncertain conflict, and shifts the resolution of any conflicting legal or policy concerns away from the courts and back to Congress, where it belongs.

expansion," enable companies to raise prices "by more than is necessary" to pass through settlement costs, and "have a disproportionate effect on" NPMs, stifling their ability to "effectively compete in the market." *Supra* at 10 n.6. Because of such concerns, Congress declined to enact the proposed legislation. It should be obvious that an agreement among the States and the tobacco industry to do precisely what Congress decided not to do – and that violates the plain text of the Sherman Act – is at least a "potential" infringement on federal authority.[14]

- The MSA's extraterritorial fees on national cigarette sales and restrictions on national advertising, lobbying, and litigation, even in States that are not parties to the MSA, likewise establish *at least* the potential for encroachment on federal authority.[15] Congress

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[14] The existence of at least a potential conflict also is reflected in the Fifth Circuit's reliance on *Parker*'s disfavored and counter-textual implied immunity. And Congress certainly has viewed anticompetitive multistate agreements as encroaching upon its authority sufficiently to warrant greater national supervision through protective conditions on its consent, without regard to the prospect of *Parker* immunity. *E.g.*, 73 Stat. 290 (1959) (requiring periodic resubmission of the Oil & Gas Compact, forbidding state cartels or price stabilization (Art. V), and ordering attorney general to investigate whether it promotes monopoly).

[15] The Fifth Circuit did not even address such extraterritorial restrictions, but instead held that the *Escrow Statute* had no extraterritorial application, an issue that was not in contention on appeal. App. A10-A11.

has itself imposed restrictions on advertising, sometimes choosing expressly to preempt contrary or additional state requirements. 15 U.S.C. § 1334. Even apart from congressional legislation, extraterritorial action is outside the authority of individual States. *See Healy* v. *Beer Institute,* 491 U.S. 324, 336 (1989) (Constitution "precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State."); *Miller Bros.* v. *Maryland*, 347 U.S. 340, 342 (1954) ("no principle is better settled than that the power of a State * * * in respect to property, is limited to such as is within its jurisdiction").

- The MSA has at least the *potential* to interfere with Congress's access to unfettered information and opinion regarding matters of national importance. One remarkable feature of the MSA is that it forbids both private and governmental members from taking positions adverse to it. Companies may not challenge the MSA or even lobby Congress or the States in any manner opposed to the MSA. MSA § III(m). States likewise must "support the integrity and enforcement of" the MSA and may not "directly or indirectly" support any challenge to the MSA. MSA § XVIII(*l*). Such binding and perpetual gag rules barring communication with Congress on subjects within congressional jurisdiction has long been recognized in other contexts as having

the potential to encroach upon federal sovereignty. *Cf. United States* v. *Cruikshank*, 92 U.S. 542, 552-53 (1876) (right to petition Congress is "an attribute of national citizenship" and a right "within the scope of the sovereignty of the United States").

C. The MSA Potentially and Actually Encroaches upon State Authority and Interests.

A further purpose of the Compact Clause is to protect the States from agreements that "might affect injuriously the interest of the other[]" States or "derange[]" States' "federal relations with other States. *Florida* v. *Georgia*, 58 U.S. at 494; *Rhode Island* v. *Massachusetts*, 37 U.S. at 726. The Fourth Circuit and the court of appeals below entirely ignored the MSA's encroachment on sister-state interests, effectively excising this component of the Compact Clause's purpose and reach.

The MSA, once again, raises no lack of potential injury and derangement to be covered by the Compact Clause:

- The MSA's extraterritorial fees and restrictions manifestly encroach upon the sovereignty of non-member States, in addition to encroaching on federal supremacy. *See supra* at 31-32.

- The MSA severely restricts the sovereignty of its member States. State legislatures were coerced into adopting Escrow Statutes when presented with the MSA as a *fait acompli* by the Attorneys General and the tobacco com-

> panies, and faced severe penalties for non-compliance. The agreement is binding on the States, which may not withdraw from and may not modify the agreement without unanimous consent from affected parties. The agreement effectively allows some member States to tax cigarette sales in other member States. Member States are subject to the binding determinations of a non-public body – the Firm – which issues unappealable decisions regarding compliance and the distribution of MSA proceeds. And States may not even voice their objections to the MSA, which forbids them from taking positions adverse to it. *See supra* at 7-10. Such multilateral restrictions on sister States could not be attempted legally, or accomplished effectively, by individual States acting without the aid of an enforceable agreement.

Once again, the MSA is the polar opposite of the agreement in *MTC*, unquestionably "redound[ing] to the benefit of [a] particular group of States [and] to the harm of others." *MTC*, 434 U.S. at 477-78.

This Court should grant certiorari both to correct the constitutionally destructive legal standard applied by the court below and the Fourth Circuit, and to decide whether a binding agreement as sweeping and significant as the MSA is indeed subject to the Compact Clause.

III. This Petition Presents Important Issues Having a Tremendous Impact on the National Economy and Our Federal System.

This case presents issues of tremendous national importance that should be resolved by this Court.

The absence of a split regarding the MSA in no way undermines the importance of the questions presented and is not a sufficient reason to decline review. Compact Clause cases rarely generate a circuit split, yet still receive this Court's attention. *See, e.g.*, *Northeast Bancorp* v. *Board of Governors of the Federal Reserve Sys.*, 472 U.S. 159, 162 (1985). Cases involving related structural restraints in Article I, § 10, cl. 3 – such as the Tonnage Clause – likewise have been reviewed by this Court even in the absence of a split. *See, e.g.*, *Polar Tankers, Inc.* v. *City of Valdez*, 129 S. Ct. 2277, 2281 (2009).

This Court has repeatedly recognized that a circuit split is not the *sine qua non* of reviewability for cases involving issues of sufficient economic or legal importance. This Term alone, this Court has granted several petitions that have not alleged any split – merely important or economically significant questions. *See, e.g.*, Petition at 5, *Schwarzenegger* v. *Entertainment Merchants Ass'n* (No. 08-1448) (May 19, 2009) (acknowledging lack of a split); Petition at 8, *Costco Wholesale Corp.* v. *Omega, S.A.* (No. 08-1423) (May 18, 2009) (same); Petition, *Flores-Villar* v. *United States* (No. 09-5801) (Aug. 3, 2009) (no split alleged); Petition at 11-12, *Chamber of Commerce* v. *Candelaria*, (No. 09-115) (July 24, 2009) (same).

And there can be little doubt that this case presents issues of great economic, political, and legal importance.

Economically, the MSA annually regulates roughly $80 billion in national cigarette sales and literally *trillions* of dollars in sales over the life of the agreement. By suppressing competition, the MSA raises prices by many billions of dollars each year, with the States and participating tobacco companies splitting the supra-competitive profits. On sheer dollar value alone, this case is significant enough to warrant this Court's attention.

Politically, the MSA has allowed an independent confederacy of States to extract revenues from citizens across the nation without passing a tax through normal democratic processes, and without political accountability in individual States. Because the MSA is binding on present and future officials, they can disclaim responsibility and cannot alter or withdraw from the MSA regardless of electoral outcomes. Such bold circumvention of democratic processes is of deep concern for its own sake, for the precedent it sets, and for the damage it does to our system of federalism and its division of power and responsibility. *See, e.g*, *United States* v. *Lopez*, 514 U.S. 549, 576-77 (1995) (Kennedy, J., concurring) (benefits of federalism in enhancing liberty require "distinct and discernable lines of political accountability"; "the inability to hold either branch of government answerable to the citi-

zens is more dangerous even than devolving too much authority to the remote central power").[16]

Legally, the court below and other federal courts have dismissed the MSA's serious legal and constitutional failings by casually extending implied immunity under the Sherman Act and by narrowing the scope of the Compact Clause in ways that have no precedent in this Court's cases, go far beyond the contexts of the cases they cite, disregard and indeed pervert the underlying reasoning in those cases, and conflict with the plain statutory and constitutional texts at issue. These rulings severely undermine the Sherman Act, effectively nullify the Compact Clause, and overreach the role of lower courts by expanding this Court's limited cases to the detriment of a federal statute and the Constitution. That the federal courts have uniformly committed such errors in sustaining the MSA simply makes matters worse, and highlights the necessity for this Court to step in as final arbiter.

In short, the MSA is an economic, political, and legal abomination backed by powerful vested interests and upheld by inadequate and destructive legal reasoning. This is the only Court in a position to offer an authoritative and definitive evaluation of that scheme and to decide whether it is indeed as innocuous as its supporters claim, or whether it must be

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[16] This case is *not* about the merits of regulating cigarettes or the desirability of higher prices to deter smoking. It is about the manner in which such choices are to be made, and who will be accountable for those choices. There are sufficient means of regulating and taxing cigarettes – including submitting the MSA to Congress for approval – that do not trench on democratic processes or federal authority.

invalidated as incompatible with federal law and the Compact Clause.

CONCLUSION

For the reasons above, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, N.W.
Washington, D.C. 20008
(202) 237-8165

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

Counsel for Petitioners

Dated: November 8, 2010

APPENDICES

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APPENDIX A

614 F.3d 172

United States Court of Appeals,
Fifth Circuit.

S&M BRANDS, INC.; Tobacco Discount House # 1, Inc.; Mark Heacock, Plaintiffs-Appellants,

v.

James D. "Buddy" CALDWELL, in his official capacity as Attorney General State of Louisiana, Defendant-Appellee.

No. 09-30985.

Aug. 10, 2010.

Appeal from the United States District Court for the Western District of Louisiana.

Before DAVIS, SMITH and HAYNES, Circuit Judges.

W. EUGENE DAVIS, Circuit Judge:

Plaintiffs appeal the district court's grant of summary judgment in favor of the Attorney General of Louisiana. This case arises out of the Master Settlement Agreement ("MSA") reached in the 1990s between the four largest tobacco manufacturers and the several states. The plaintiffs-who are not signatories to the MSA-sued the Louisiana Attorney General, alleging that the MSA and the Louisiana*174 Escrow Statute, LA.REV.STAT. § 13:5061, *et seq.*, violate the Compact Clause, First Amendment, Federal Ciga-

rette Labeling and Advertising Act ("FCLAA"), Commerce and Due Process Clauses, and federal antitrust laws. For the following reasons, we AFFIRM.

I.

In 1994, several states, including Louisiana, brought lawsuits against the four largest tobacco manufacturers: Philip Morris, R.J. Reynolds, Lorillard, and Brown & Williamson (collectively referred to as the Original Participating Manufacturers "OPMs"). The states alleged that the OPMs' tobacco products, as well as the marketing related to their tobacco products, cost the states billions of dollars in increased health care costs.

In 1998, the OPMs reached a settlement agreement, the MSA, with fifty-two governmental entities (collectively referred to as the "Settling States"), including Louisiana. The MSA released the OPMs from past, present, and future tobacco-related legal claims. In return, the OPMs were prohibited from participating in certain types of tobacco-related state and federal lobbying, engaging in litigation adverse to the MSA or its enacting state statutes, and various types of advertising. The OPMs also were required to make annual payments into a fund (hereinafter "the MSA fund") based on their present market share. Money paid into the MSA fund is paid out in fixed shares to the individual Settling States.

Smaller tobacco manufacturers that were not part of the OPMs were permitted to join the MSA as Subsequent Participating Manufacturers ("SPMs"). The MSA created two groups of SPMs. The first group (hereinafter the "grandfathered SPMs") included those SPMs that signed on to the MSA within the

first 90 days of its execution. As a means of encouraging smaller tobacco manufacturers to become grandfathered SPMs, the MSA provides that grandfathered SPMs do not have to pay into the MSA fund, so long as their market share does not exceed the greater of their 1998 sales or 125% of their 1997 sales. The second group (hereinafter the "non-grandfathered SPMs") are those SPMs that joined the MSA after 90 days of its execution. Non-grandfathered SPMs must pay into the MSA fund based on their annual market share, but unlike grandfathered SPMs, they need not remain at the same market size as when the MSA was executed. Both grandfathered SPMs and non-grandfathered SPMs must abide by the aforementioned prohibitions in lobbying, litigation, and advertising that OPMs are subject to under the MSA.

In return for the above concessions, the MSA encourages, but does not demand, that the Settling States pass a Model Statute (hereinafter the "Escrow Statute"). The Escrow Statute requires that tobacco manufacturers not participating in the MSA (referred to as Non-Participating Manufacturers ("NPMs")) and selling tobacco products in the state either (1) join the MSA or (2) make an annual deposit into a qualified escrow account based on the quantity of cigarettes the NPM sold in the state during the previous calendar year. To encourage the Settling States to pass the Escrow Statute, the NPM Adjustment was created. The MSA provides that if any of the OPMs, grandfathered SPMs, or non-grandfathered SPMs (collectively the "PMs") lose its market share, a nationally-recognized firm of economists will be hired to determine whether the loss in market share is due to

the aforementioned restraints in lobbying, litigation, and advertising required by the MSA. If those restraints are determined by the economists to be a significant factor contributing*175? to the loss of market share, then the PM may reduce the amount it pays into the MSA fund. This reduction is the NPM Adjustment, which is borne only by the Settling States that have not enacted the Escrow Statute. Louisiana enacted an Escrow Statute, LA.REV.STAT. § 13:5061, *et seq.* Under the Louisiana Escrow Statute, if an NPM fails to join the MSA or fails to make the appro-priate annual deposit into a qualified escrow account, the NPM is subject to civil and criminal penalties. LA.REV.STAT. §§ 13:5073, 5076. However, if an NPM pays more to the qualified escrow account than it would have to pay if it were a non-grandfathered SPM, the NPM is entitled to a refund of the excess amount it paid. LA.REV.STAT. § 13:5063(C)(2)(b).

II.

Since its implementation, several NPMs and smokers have challenged the validity of the MSA and state Escrow Statutes before a number of courts, including, most recently, this court.[1] This case is yet another challenge to the MSA and Louisiana Escrow Statute.

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[1] *See, e.g., Xcaliber Int'l Ltd. LLC v. Caldwell,* No. 09-30492, 612 F.3d 368, 2010 WL 2773431, 2010 U.S.App. LEXIS 14513 (5th Cir. Jul. 15, 2010); *Grand River Enters. Six Nations v. Beebe,* 574 F.3d 929 (8th Cir. 2009); *KT&G Corp. v. Six,* 535 F.3d 1114 (10th Cir. 2008); *Grand River Enters. Six Nations v. Pryor,* 425 F.3d 158 (2d Cir. 2005); *Star Sci., Inc. v. Beales,* 278 F.3d 339 (4th Cir. 2002).

The plaintiffs[2] filed suit against the defendant, Louisiana Attorney General Buddy Caldwell, seeking to invalidate the MSA and Louisiana Escrow Statute on the grounds that they were unconstitutional because they violated the Compact Clause, the First Amendment, the Commerce Clause, and the Due Process Clause. The plaintiffs further alleged the MSA and Escrow Statute violated federal antitrust laws, the FCLAA, and the Bankruptcy Code.

Following proceedings before the district court, both parties filed motions for summary judgment. Finding there were no genuine issues of material fact, and that the plaintiffs' claims failed as a matter of law, the district court granted the Attorney General's motion for summary judgment and dismissed the plaintiffs' claims with prejudice. The plaintiffs timely filed this appeal. On appeal, the plaintiffs press all of the aforementioned challenges except for their allegation that the MSA and Escrow Statute violate the Bankruptcy Code.

We review the district court's grant of summary judgment *de novo*. *Breaux v. Halliburton Energy Services,* 562 F.3d 358, 364 (5th Cir. 2009) (citing *LeMaire v. La. Dep't of Transp. & Dev.,* 480 F.3d 383, 386 (5th Cir. 2007)).

III.

We first address the plaintiffs' assertion that the MSA violates the Compact Clause, U.S. CONST., Art.

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[2] The specific parties in this case include a cigarette manufacturer who has not joined the MSA, i.e. an NPM (S&M Brands, Inc.), a cigarette dealer (Tobacco Discount House # 1), and a smoker (Mark Heacock) (collectively, "the plaintiffs").

I, § 10, cl. 3, because it is an agreement among the Settling States that has the potential to interfere with the plaintiffs' constitutional rights and has not been approved by Congress. The district court found that the proper analysis to determine whether congressional approval is required under the Compact Clause is the test provided in *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 473, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978): "whether ***176** the Compact enhances state power *quoad* the National Government." Because the MSA only increases states' power *vis-a-vis* the PMs and not in relation to the federal government, the district court concluded there was no violation of the Compact Clause.

The Fourth Circuit in *Star Sci.* reached this same end. *See* 278 F.3d at 359-60. The *Star Sci.* court stated:

> Although the Master Settlement Agreement implicates the Compact Clause, we see no reason to conclude that it encroaches on federal power. In *Multistate Tax Commission,* the Supreme Court upheld a compact resulting in reciprocal State legislation and establishing an administrative body to coordinate State taxation of certain entities. The Court noted that the compact might result in an increase in bargaining power of the member States with respect to the corporations subject to their taxing jurisdictions, but it found such an increase in power to be acceptable because "the test is whether the Compact enhances state power quoad the National Government." Similarly,

> the Master Settlement Agreement may result in an increase in bargaining power of the States *vis-a-vis* the tobacco manufacturers, but this increase in power does not interfere with federal supremacy because the Master Settlement Agreement "does not purport to authorize the member States to exercise any powers they could not exercise in its absence."

278 F.3d at 360. *See also Vibo Corp. v. Conway,* 594 F.Supp.2d 758, 785-86 (W.D. Ky. 2009) (finding that the MSA does not violate the Compact Clause because "[a]n increase in the states' collective bargaining power does not result in an accompanying decrease of federal power").

We agree with the reasoning expressed by the Fourth Circuit and the district court in the instant case, and accordingly find no merit in the plaintiffs' Compact Clause challenge.

IV.

The plaintiffs also argue that the MSA and Escrow Statute are *per se* violations of the Sherman Act, 15 U.S.C. § 1, because the structure of the MSA creates a national cigarette cartel designed to increase the prices paid out to the OPMs and protect the OPMs market share. The plaintiffs further assert that the only defense potentially available to the Attorney General is the implied state-action immunity found under *Parker v. Brown,* 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943), but that such immunity does not apply in this case where Louisiana acted as a private player when it entered an agreement with other states and the OPMs to restrain trade.

The plaintiffs' argument that the Escrow Statute is a *per se* violation of the Sherman Act is foreclosed by this court's recent decision in *Xcaliber*. The *Xcaliber* court concluded that the Escrow Statute did not "mandate or authorize conduct that necessarily constitutes a violation of the antitrust laws in all cases." 612 F.3d 368, 375, 2010 WL 2773431, *4, 2010 U.S.App. LEXIS 14513, at *14 (quoting *Rice v. Norman Williams Co.*, 458 U.S. 654, 661, 102 S.Ct. 3294, 73 L.Ed.2d 1042 (1982)). Moreover, the *Xcaliber* court found that the Escrow Statute did not "pressure [NPMs] to conspire together to set a specific price, to carve up markets, or otherwise to violate antitrust law." *Id.* (citation omitted). Thus, this court's precedent in *Xcaliber* precludes the plaintiffs' argument that the Escrow Statute violates the Sherman Act.

This court's decision in *Xcaliber,* however, does not complete our antitrust analysis. In *Xcaliber,* the court was faced with *177 a challenge to only the Escrow Statute. *See id.* at 375, 2010 WL 2773431, *3 n. 5, 2010 U.S.App. LEXIS 14513 *12 n. 5. In the present case, the plaintiffs challenge both the Escrow Statute *and* the MSA. Thus, we must also consider whether the MSA and Escrow Statute working together create an antitrust violation.

Whether the MSA and Escrow Statute violate federal antitrust laws has been addressed by the Sixth, Eighth, and Ninth Circuits, and all of those courts have rejected the plaintiffs' arguments. *See Grand River Enters. Six Nations,* 574 F.3d at 936-38; *Sanders v. Brown,* 504 F.3d 903, 908-11 (9th Cir. 2007); *Tritent Int'l Corp. v. Kentucky,* 467 F.3d 547, 557

(6th Cir. 2006). *See also S&M Brands, Inc. v. Summers,* 393 F.Supp.2d 604, 622 (M.D. Tenn. 2005), *aff'd by, S&M Brands, Inc. v. Summers,* 228 Fed.Appx. 560 (6th Cir. 2007) (finding that the MSA and Escrow Statute were immune from challenge on antitrust grounds under the state-action doctrine). The Sixth Circuit in *Tritent* aptly described the argument the present plaintiffs raise and why it must be rejected:

> The PMs' practice of increasing cigarette prices, thus keeping sales volume down, has allowed them to maintain a stable market share. This has resulted in lower payments to the settling states. If Tritent and the other NPMs had chosen not to raise their prices in response to the PMs' price increase, the NPMs' market share would have presumably increased, but this would have subjected them to higher payments under the Escrow Statute. Kentucky's current statutory scheme ... thus provides a disincentive for the NPMs to engage in price competition with the PMs. The genesis of this anticompetitive behavior, however, stemmed neither from the MSA nor the complementary legislation that Kentucky enacted to give effect to the MSA's provisions. Instead, the behavior with which Tritent *really* takes issue is the behavior of the PMs following the MSA's enactment. Because such behavior was neither mandated nor explicitly authorized by the state of Kentucky, *McNeilus* [*Truck & Mfg., Inc. v. State ex rel. Montgomery,* 226

> F.3d 429 (6th Cir.2000)] forecloses Tritent's argument on this issue.

467 F.3d at 557.

We agree with the Sixth Circuit and the other circuits that have already considered the issue of whether the MSA and Escrow Statute violate the Sherman Act, and we adopt their rationale. Accordingly, we find no merit to the plaintiffs arguments that the MSA and Escrow Statute violate federal antitrust laws.

V.

The plaintiffs also briefly argue that the MSA and Escrow Statute violate the Commerce Clause and Due Process Clause because they create extraterritorial price increases.

The plaintiffs' claims have been soundly rejected by the Fourth, Eighth, and Tenth Circuits. *See Grand River Enters. Six Nations,* 574 F.3d at 943-44; *KT&G Corp.,* 535 F.3d at 1145-46; *Star Sci., Inc.,* 278 F.3d at 356-57. In examining whether the Arkansas Escrow Statute created extraterritorial price increases, the Eighth Circuit stated,

> NPM escrow payments are entirely a function of an NPM's sales in Arkansas. The payments are not based on nationwide sales. Nor has there been a showing by appellants that escrow payments by NPMs in Arkansas have any effect, either directly or indirectly, on cigarette prices in other states. NPMs must make escrow payments *to* Arkansas based on that NPM's cigarette sales *in* *178 Arkansas. Arkansas has no control over cigarette prices in

> other states. The MSA calculates an NPM's hypothetical MSA payment in order to refund the excess back to that NPM, but it does not allow Arkansas to control commerce in other states.

Grand River Enters. Six Nations, 574 F.3d at 944. We agree with the Eighth Circuit's analysis. The Louisiana Escrow Statute and the MSA only allow Louisiana to regulate and collect escrow payments based on the sale of cigarettes within Louisiana's jurisdiction. Therefore, there is no violation of the Due Process or Commerce Clause.

VI.

The remaining challenges brought by the plaintiffs rest on the underlying argument that NPMs are compelled to join the MSA to avoid the economic burdens imposed on them by the Escrow Statute. This argument, however, is also foreclosed by this court's recent decision in *Xcaliber.* In *Xcaliber,* the plaintiff asserted that the Escrow Statute "makes doing business as an NPM so unattractive that it compels NPMs to join the MSA ...." 612 F.3d at 368, 380, 2010 WL 2773431, *8, 2010 U.S.App. LEXIS 14513, at *28.[3] The court disagreed, finding that there was no

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[3] In *Xcaliber,* the plaintiff challenged the Allocable Share Revocation ("ASR"). The ASR was an amendment that Louisiana, and all Settling States, passed to the original escrow statutes in order to close a loophole in the original escrow statutes that was advantageous to NPMs. *See* 612 F.3d at 368, 372-73, 2010 WL 2773431, *2-3, 2010 U.S.App. LEXIS 14513, at *6-7 (discussing the reason for the ASR). The Louisiana Escrow Statute considered in the plaintiffs' instant challenge incorporates the alteration of the ASR.

evidence that the Louisiana Escrow Statute created a price or non-price disadvantage for NPMs. *Id.* at 380-81, 2010 WL 2773431, *8-9, 2010 U.S.App. LEXIS 14513, *29-31. Because no disadvantage is created for NPMs by remaining as NPMs, NPMs are not compelled to join the MSA. *Id.* at 381, 2010 WL 2773431, *9, 2010 U.S.App. LEXIS 14513, *31.

Based on the *Xcaliber* court's conclusion that the Escrow Statute does not compel NPMs to become signatories to the MSA, any argument by the plaintiffs based on this premise is foreclosed. With this in mind, we turn to the plaintiffs' claims that the MSA and the Louisiana Escrow Statute violate the First Amendment, the FCLAA, the Commerce Clause and the Due Process Clause, and antitrust laws.

A.

The plaintiffs argue that the MSA and Louisiana Escrow Statute violate the First Amendment because the MSA directly restrains the speech of PMs by forbidding various forms of lobbying and petitioning activity concerning tobacco products and the MSA itself, as well as prohibiting numerous forms of cigarette advertising.

This same argument was raised in *S&M Brands, Inc. v. Summers,* 393 F. Supp.2d 604 (M.D. Tenn. 2005), *aff'd, S&M Brands, Inc. v. Summers,* 228 Fed.Appx. 560, 563 (6th Cir. 2007). In that case, the court stated,

> The Escrow Act ... leaves [NPMs] no worse off financially than they would be under the MSA, because it expressly provides that [NPMs] are entitled to a refund on any amounts paid into escrow that they can demonstrate is in excess

> of the amount they would have paid under the MSA. Further, [NPMs] retain all of the First Amendment and other rights that the PMs gave up when they signed the MSA.

*179 *Id.* at 638. *See also KT&G Corp.*, 535 F.3d at 1134-36 (holding that an escrow statute did not violate NPMs First Amendment rights).

We agree with this reasoning. While the MSA does restrict the speech activities of PMs, the plaintiffs are not PMs and, as previously noted, are not coerced to become PMs. The only statute applicable to the plaintiffs is the Louisiana Escrow Statute, which in no way compels or abridges speech. Therefore, we find no merit to the plaintiffs' First Amendment claims.

B.

The FCLAA states that "[n]o requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this chapter." 15 U.S.C. § 1334(b). The plaintiffs argue that the MSA and Escrow Statute violate the FCLAA because the FCLAA preempts state regulations targeting cigarette advertising, and the MSA and Escrow Statute prohibit certain forms of cigarette advertising.

This same argument has been raised and rejected in *Grand River Enters. Six Nations, Ltd. v. Pryor*, 2003 U.S. Dist. LEXIS 16995, at *48-50 (S.D.N.Y. 2003), *aff'd by, Grand River Enters. Six Nations, Ltd.*, 425 F.3d at 175, and *PTI, Inc. v. Philip Morris Inc.*, 100 F. Supp.2d 1179, 1205 (C.D. Cal. 2000). Like the district court below, we agree with the rationale

expressed in those decisions. The plaintiffs are not compelled to join the MSA and the Louisiana Escrow Statute "does not have any connection whatsoever with cigarette packaging, advertising, or promotion." *PTI, Inc.*, 100 F.Supp.2d at 1205. Therefore, the plaintiffs' FCLAA argument must fail.

CONCLUSION

For the above reasons, we AFFIRM the district court's grant of summary judgment in favor of the Attorney General.

AFFIRMED.

APPENDIX B

Unpublished

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

A.B. COKER, INC., ET AL.	CIVIL ACTION NO. 05-1372
VERSUS	JUDGE S. MAURICE HICKS, JR.
JAMES D. "BUDDY" CALDWELL, in his official capacity as LOUISIANA ATTORNEY GENERAL	MAGISTRATE JUDGE HORNSBY

MEMORANDUM RULING

Before this Court are two cross motions for summary judgment. The Motion for Summary Judgment [Record Document 87], filed by Defendant James D. "Buddy" Caldwell, in his official capacity as the Attorney General for the State of Louisiana, is **GRANTED,** and the Motion for Summary Judgment [Record Document 95], filed by Plaintiffs S&M Brands, Inc., Tobacco Discount House #1 Inc., and

Mark Heacock, is **DENIED**. All claims by Plaintiffs are **DISMISSED WITH PREJUDICE.**

FACTUAL BACKGROUND

Beginning in 1994, the attorneys general of several States (including Louisiana) brought lawsuits against the country's four largest tobacco manufacturers alleging that their tobacco products and related marketing had cost the States billions of dollars in increased Medicaid and other healthcare costs incurred while treating the health problems caused by the use of tobacco. The States sought to recoup the costs of these medical services based on theories of consumer protection, antitrust, unjust enrichment, and other state-law remedies.

On November 23, 1998, the state lawsuits were settled by execution of the tobacco Master Settlement Agreement ("MSA"). The MSA was signed by 52 governmental jurisdictions (46 states, including Louisiana, the District of Columbia, Puerto Rico, and four territories) (collectively referred to as the "Settling States")[1] and the four major tobacco manufacturers (Philip Morris, R.J. Reynolds, Lorillard, and Brown & Williamson) (collectively referred to as the "Original Participating Manufacturers" or "OPMs"). [Doc. 1, ¶27]. The MSA released the OPMs from all past, present, and future tobacco-related legal claims initiated by the States. In return, each OPM agreed to make annual payments into a fund with each OPM's contribution based principally on its national market

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[1] Four states (Florida, Mississippi, Texas, and Minnesota) made separate individual settlements before the MSA. [Doc. 1, ¶ 27].

share. The payments are allocated among the states based upon a fixed formula, with Louisiana receiving approximately 2.26 percent of the payments as its "allocable share." In addition, the OPMs agreed to various restrictions and bans on advertising, political lobbying, and trade association activities, and relinquished legal challenges to state laws and rules regulating tobacco. Id. at ¶ 30.

Other tobacco manufacturers were permitted an opportunity to join the MSA as Subsequent Participating Manufacturers ("SPMs").[2] Those who joined the MSA within a ninety-day window from the execution of the MSA were granted an exemption on MSA payments so long as their yearly market shares do not exceed the larger of their 1998 market share or 125 percent of their 1997 market share. SPMs thus share in the profits generated by the MSA without paying any money to the Settling States, as long as they limit their sales. However, if SPMs increase their sales by selling additional packs of cigarettes, they are required to make a higher MSA payment on each additional pack they sell than the OPMs pay on each pack they sell. After the ninety-day period, other tobacco manufacturers were allowed to join the MSA, but they were not exempt from any portion of the annual payment. Id. at ¶ 34-36.

As an incentive for the Settling States to protect the OPMs market share,[3] the MSA includes a provi-

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[2] Hereinafter, OPMs and SPMs are collectively referred to as PMs.

[3] The MSA requires the OPMs to make substantial payments to the Settling States each year. These costs are "internalized" in the cost of cigarettes and largely, if not entirely, passed on to

sion that, if one of the OPMs loses market share in a particular year, a nationally recognized firm of economic consultants is to determine whether the restraints imposed on the OPMs by the MSA were a significant factor contributing to the market share loss. If so, the OPMs payments under the MSA may be reduced by as much as three times its market share loss. This potential reduction is known as the Nonparticipating Manufacturer Adjustment (or "NPM Adjustment"). The NPM Adjustment is imposed only on those states that fail to enact and enforce a Qualifying Statute prescribed by the MSA. If all but one Settling State enacted a Qualifying Statute, the entire NPM Adjustment would be applied to reduce that one state's MSA payments. Thus, there is strong incentive for all of the Settling States to enact a Qualifying Statute. Id. at ¶ 38-39.

In 1999, Louisiana enacted the "Model Statute", provided for as Exhibit T to the MSA, which is codified in Louisiana Revised Statutes 15:5061 et *seq.* ("Louisiana's Escrow Statute"). Pursuant to its terms, every NPM selling cigarettes in Louisiana is required to either (1) join the MSA and become a participating member, or (2) make an annual deposit into a qualified escrow account of a specified amount of money per cigarette sold in the State during the prior calendar year. Unlike the settlement payments made by PMs under the MSA, which become the property of the State, Louisiana has no right to an NPM's escrow

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consumers in the form of high prices. The ability of NPMs, who are not required to make payments under the MSA, to sell their brands at lower prices poses a threat to the market share held by the OPMs. *See* Doc. 87, p.7-8.

deposits unless or until it obtains a settlement or judgment of tobacco-related claims against the NPM. NPMs are entitled to receive the interest earned on each escrow deposit as it accrues, while the principal amount of each deposit must be held in escrow for twenty-five years. To the extent the funds are not released from escrow to pay a settlement or judgment during those twenty-five years, the escrow funds are to be released and revert back to the NPM. *See* La. R.S. § 5063(C)(2).

Louisiana also enacted "Complementary Legislation," codified in Louisiana Revised Statutes 13:5071 et *seq.*, which provides that in order for a brand of cigarettes to be included on a directory of brands eligible for sale in Louisiana, its manufacturer must either be a PM under the MSA or an NPM in compliance with the Escrow Statute. If cigarette makers are found in violation of the Complementary Legislation, they can be criminally prosecuted and jailed, fined $5,000 for each such violation, and can have their cigarettes seized and destroyed. The statute also subjects makers who violate it to Louisiana's unfair trade laws and other statutes.

The National Association of Attorneys General ("NAAG") is directed by the MSA to "provide coordination and facilitation for the implementation and enforcement of the [MSA] on behalf of the Attorneys General of the Settling States." [Doc. 1, ¶ 31 (citing MSA § VIII(a))]. Payments made by PMs pursuant to the MSA are not made to individual states, but into a central escrow account from which payments are later made to the Settling States. Id. at ¶ 32 (citing MSA, Exhibit B). NAAG also administers the Settling

States' Antitrust/Consumer Protection Tobacco Enforcement Fund, established with $50 million from the OPMs. One purpose of the Fund is to directly implement and enforce the MSA; another is to pay for the investigation and litigation of suspected MSA violations, including enforcement of the MSA's Consent Decrees against PMs and its Qualifying Statutes against NPMs. States must notify NAAG in advance of planned enforcement proceedings, and NAAG must coordinate discovery in such proceedings. Id. at ¶ 31 (citing MSA §§ VII(c)(2), (g), VIII(a)) In addition, NAAG must provide guidance to state assistant attorneys general and legislators about what action by States is sufficient to comply with their duty to diligently enforce the MSA. Id.

PROCEDURAL HISTORY

On August 2, 2005, A.B. Coker, Co., Inc., S&M Brands, Inc., CLP, inc., Tobacco Discount House #1, and Mark Heacock (collectively "Plaintiffs")[4] filed suit against the Louisiana Attorney General seeking to invalidate, on federal constitutional grounds, the MSA and the statutes Louisiana enacted to assist in its implementation.[5] [Doc. 1]. Plaintiffs contend the MSA and Louisiana's Escrow Statute encroach on

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[4] On April 24, 2008, Plaintiffs and Defendant stipulated that A.B. Coker, Co., Inc. and CLP, Inc. be dismissed from the action pursuant to Federal Rule of Civil Procedure 41 (a)(1)(ii), after A.B. Coker, Co., Inc. filed for bankruptcy and CLP, Inc. chose to end its participation in the lawsuit due to financial difficulties. [Doc. 71].

[5] Those statutes are Louisiana's "Escrow Statute" (La. R.S. 13:5061 *et seq.*) and its "Complementary Legislation" (La. R.S. 13:5071 *et seq.*). See, supra.

federal and state power without congressional consent, in violation of the Compact Clause, and potentially violate federal antitrust laws, the First Amendment, the Federal Cigarette Labeling and Advertising Act, and the Bankruptcy Code; are preempted by the Federal Cigarette Labeling and Advertising Act; and impose extraterritorial regulation of interstate commerce in violation of the Commerce Clause and Due Process Clause.[6] [Docs. 1, 111].

Shortly after the Complaint in this action was filed, the Attorney General sought to have it dismissed pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. *See* Doc. 13. The Magistrate Judge issued a Report and Recommendation [Doc. 43] recommending that the complaint be dismissed. This Court, however, stated that while it was "inclined to agree with the reasoning of Magistrate Hornsby's Report and Recommendation, it [was] constrained by the Fifth Circuit's decision in Xcaliber Int'l Ltd., LLC v. Foti, 442 F3d 233 (5th Cir. 2006)," wherein the Fifth Circuit found that the District Court for the Eastern District of Louisiana erred by granting a Rule 12(b)(6) motion to dismiss a tobacco manufacturer's challenge to Louisiana's Escrow Statute and

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[6] In the Complaint, Plaintiffs also asserted that the MSA and Escrow Statutes violated the Tenth Amendment "by commandeering state legislatures to adopt the Qualifying Statute and delegating their powers to bodies outside the control of either the state or federal governments." [Doc. 1, ¶ 85]. However, the Court dismissed this claim on November 9, 2006, as it was undisputed that the federal government had no involvement with the MSA. *See* Docs. 43, 47, 48.

remanded the case for further proceedings. *See* Doc. 48.

The parties are now before the Court on cross motions for summary judgment. Plaintiffs contend they are entitled to a declaration that the MSA and Escrow Statutes are unconstitutional as a matter of law, and seek to have the Attorney General enjoined from enforcing the MSA and Escrow Statutes. [Doc. 111]. The Attorney General, however, seeks dismissal of the Complaint in its entirety. In support of its motion, the Attorney General points to a significant and growing body of jurisprudence that has rejected claims virtually identical to those asserted by Plaintiffs in this action, including the Eastern District of Louisiana which recently addressed cross motions for summary judgment in Xcaliber and dismissed the plaintiff's claims against the Attorney General. *See* Xcaliber Int't Ltd., LLC v. Caldwell, 2009 WL 1324042 (E.D. La. 2009).

LAW AND ANALYSIS

1. Summary Judgment Standard

Summary judgment is proper pursuant to Rule 56 of the Federal Rules of Civil Procedure "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552 (1986). Rule 56(c) "mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essen-

tial to that party's case, and on which that party will bear the burden of proof at trial." Id., 477 U.S. at 322, 106 S. Ct. at 2552. If the party moving for summary judgment fails to satisfy its initial burden of demonstrating the absence of a genuine issue of material fact, the motion must be denied, regardless of the nonmovant's response. Little v. Liquid Air Corp., 37 F.3d 1069, 1075 (5th Cir. 1994) (en banc). If the motion is properly made, however, Rule 56(c) requires the nonmovant to go "beyond the pleadings and designate specific facts in the record showing that there is a genuine issue for trial." Wallace v. Texas Tech. Univ., 80 F.3d 1042,1047 (5th Cir. 1996) (citations omitted). The nonmovant's burden may not be satisfied by conclusory allegations, unsubstantiated assertions, metaphysical doubt as to the facts, or a scintilla of evidence. Little, 37 F.3d at 1075; Wallace, 80 F.3d at 1047. All factual controversies must be resolved in favor of the nonmovant. Cooper Tire & Rubber Co. v. Farese, 423 F.3d 446, 456 (5th Cir. 2005).

2. Constitutional Claims

A. Compact Clause

The Compact Clause of Article I, § 10, of the United States Constitution, provides: "No State shall, without the Consent of Congress,. . . enter into any Agreement or Compact with another State, or with a foreign Power." U.S. Const. art. I, § 10, cl. 3. It is well established that the Compact Clause is not to be applied to every agreement between the States, only "to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of

the United States." Virginia v. Tennessee, 148 U.S. 503, 519, 13 S.Ct. 728, 734 (1893); see also, Northeast Bancorp, Inc. v. Board of Governors of the Fed. Res. Sys., 472 U.S. 159, 175-76, 105 S.Ct. 2545, 86 L.Ed.2d 112 (1985); United States Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 468, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978); New Hampshire v. Maine, 426 U.S. 363, 369, 96 S.Ct. 21 13, 48 L.Ed.2d 701 (1976). The test under the Compact Clause, therefore, is "whether the Compact enhances state power *quoad* the National Government." Multistate Tax Comm'n, 434 U.S. at 473, 98 S.Ct. at 813. The agreement or compact does not have to actually usurp the power of the federal government; rather, "the pertinent inquiry is one of potential, rather than actual, impact upon federal supremacy." Id. at 812.

Plaintiffs assert that the MSA is an "Agreement or Compact" among the States for purposes of the Compact Clause, and that it is invalid because it has not been submitted to or approved by Congress.[7] [Doc. 1,

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[7] Specifically, Plaintiffs claim congressional consent was required to validate the MSA because the MSA and its supplemental statutes "encroach upon federal supremacy by patently violating the federal antitrust laws, including the Sherman Act;" that the MSA "encroaches upon federal authority and policy by establishing a comprehensive regulatory scheme governing the advertising and promotion of cigarettes," in violation of the preemption provisions of the Federal Cigarette Labeling and Advertising Act, First Amendment, and the Dormant Commerce Clause; "encroaches upon federal supremacy by establishing a nationwide excise tax on cigarettes in the form of annual, perpetual payments by PMs and NPMs (in the form of escrow payments);" prohibits protected lobbying activity in violation of the speech and petition clauses of the First Amendment; and "conflicts with the federal Bankruptcy Code by giving Settling

¶¶ 58-59]. In opposition, the Attorney General contends Plaintiffs' Compact Clause is not applicable to the MSA and, therefore, the Settling States were not required to obtain congressional consent for the MSA. Even if congressional consent was necessary, the Attorney General claims Congress provided it. *See* Docs. 13, 87.

States an unfair advantage over tobacco companies' other creditors." [Doc. 1, ¶¶ 62-65, 661. But see, Xcaliber Int'l Ltd., LLC v. Caldwell, 2009 WL 1324042 (E.D. La. May 7, 2009) (Sherman Act, First Amendment, equal protection, due process); KT&G Corp. v. Attorney Gen. of the State of Oklahoma, 535 F.3d 1114 (10th Cir. 2008) (Sherman Act, First Amendment, equal protection, due process, Commerce Clause); S&M Brands, Inc. v. Cooper, 527 F.3d 500 (6th Cir. 2008) (State sovereign immunity); S&M Brands, Inc. v. Summers, 228 Fed. Appx. 560 (6th Cir. 2007) (Sherman Act, preemption); Star Scientific, Inc. v. Beales, 278 F.3d 339 (4th Cir. 2002), cert. denied, Star Scientific, Inc. v. Kilgore, 537 U.S. 818, 123 S.Ct. 92 (2002) (due process, equal protection, Commerce Clause, Compact Clause); Int'l Tobacco Partners, Ltd. v. Kline, 475 F.Supp.2d 1078 (D.Kan. 2007) (Sherman Act, Dormant Commerce Clause); Grand River Enterprises Six Nations, Ltd. v. Beebe, 41 8 F.Supp.2d 1082 (W.D.Ark. 2006) (antitrust state action immunity doctrine, First Amendment, equal protection, due process, Commerce Clause, Supremacy Clause); Mariana v. Fisher, 226 F.Supp.2d 575 (M.D.Penn. 2002), aff'd, 338 F.3d 189, 198 (3rd Cir. 2003), g&. denied, Mariana v. Pappert, 540 U.S. 11 79, 124 S.Ct. 141 3 (2004) (Sherman Act, *Noerr-Pennington doctrine*, Commerce Clause, Compact Clause); PTI, Inc. v. Philip Morris, Inc., 100 F.Supp.2d 11 79 (C.D. Cal. 2000) (*Noerr-Pennington doctrine*, antitrust state action immunity doctrine, Compact Clause, bill of attainder, Commerce Clause, preemption, equal protection, due process); Hise v. Philip Morris, Inc., 46 F.Supp.2d 1201 (N.D. Okla. 1999), aff'd, 208 F.3d 226 (10th Cir. 2000), cert. denied, 531 U.S. 959, 121 S.Ct. 384 (2000) (Sherman Act/*Noerr-Pennington* doctrine, due process, Compact Clause).

Addressing this same argument, the Fourth Circuit concluded that the MSA implicates the Compact Clause to the extent the States agree on the creation of a single administrative body of national economic consultants. Star Scientific, Inc. v. Beales, 278 F.3d 339, 360 (4th Cir. 2002). However, the Court saw "no reason to conclude that [the MSA] encroaches on federal power." The Fourth Circuit relied on Multistate Tax Comm'n, wherein the United States Supreme Court rejected similar challenges to the Multistate Tax Compact:

> On its face the Multistate Tax Compact contains no provisions that would enhance the political power of the member States in a way that encroaches upon the supremacy of the United States. There may well be some incremental increase in the bargaining power of the member States *quoad* the corporations subject to their respective taxing jurisdictions. Group action in itself may be more influential than independent actions by the States. But. . . [t]his pact does not purport to authorize the member States to exercise any powers they could not exercise in its absence. Nor is there any delegation of sovereign power to the Commission; each State retains complete freedom to adopt or reject the rules and regulations of the Commission. . .

434 U.S. at 472-73, 98 S.Ct. at 812-13.

Similarly, while the MSA may result in an increase in bargaining power of the States vis-a-vis the tobacco manufacturers, this increase in power does not interfere with federal supremacy. The MSA "does

not purport to authorize the member States to exercise any powers they could not exercise in its absence." Star Scientific, 278 F.3d at 260 (quoting Multistate Tax Comm'n, 434 U.S. at 473, 98 S.Ct. at 813); see also, Mariana v. Fisher, 226 F.Supp.2d 575 (M.D.Penn. 2002).[8] Nor does the MSA derogate from the power of the federal government to regulate tobacco, as sections X and XVIII(a) specifically provide for adjustments of the MSA's terms in the event Congress passes future laws regulating tobacco and section XVIII(w)(1)(c) expressly states that the provision is enforceable only if consistent with the Bankruptcy Code. *See* MSA §§ X, XVIII(a), XVIII(w)(1)(c). Furthermore, each Settling State could have independently settled its claims against the OPMs, included in the settlement agreements the same provisions contained within the MSA, and independently enacted the Model Act (or Qualifying Escrow Statute). See PTI, Inc. v. Philip Morris, Inc., 100 F. Supp.2d 1179, 1198 (C.D. Cal. 2000). The mere fact that the States acted collectively to settle their disputes with the participating tobacco manufacturers does not establish an encroachment on federal supremacy. Thus, in the absence of any actual or potential encroachment or interference, the Compact Clause does not apply to the MSA and the Settling States were not required to obtain congressional consent.

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[8] Affirmed on jurisdictional grounds without addressing the merits, 338 F.3d 189, 198 (3rd Cir. 2003), cert. denied, Mariana v. Pappert, 540 U.S. 1179, 124 S.Ct. 1413 (2004).

Even if the MSA did require congressional consent, the Court agrees with the Attorney General that Congress has plainly provided it. The Supreme Court has long held that "Congress may consent to an interstate compact by authorizing joint state action in advance *or by giving expressed or implied approval to an agreement the States have already joined.*" Cuyler v. Adams, 449 U.S. 433,441, 101 S.Ct. 703, 708, 66 L.Ed.2d 641 (1981) (emphasis added) (citing Virginia v. Tennessee, supra, 148 U.S. at 521, 13 S.Ct. at 735; Green v. Biddle, 8 Wheat. I , 85-87, 5 L.Ed. 547 (1823)). In this case, Congress expressly recognized the MSA's existence in 1999, when amending the Medicaid statute, and disclaimed any federal interest in the moneys received by the Settling States pursuant to the Agreement. Specifically, the amendment provided that the federal rules governing health overpayments

> (i). . .shall not apply to any amount recovered or paid to a State as part of the comprehensive settlement of November 1998 between manufacturers of tobacco productions. . .and State Attorneys General, or as part of any State settlement or judgment reached in litigation initiated or pursued by a State against one or more manufacturers.
>
> (ii). . . a State may use amounts recovered or paid to the State as part of a comprehensive or individual settlement, or a judgment, described in clause (i) for any expenditures determined appropriate by the State.

42 U.S.C. § 1396b(d)(3)(B)(i-ii). Unquestionably, Congress' express reference to the MSA and its provision

for disposition of the settlement proceeds to the Settling States demonstrates Congress' approval to the agreement.

Accordingly, for all the reasons stated above, the Court finds that Plaintiffs' Compact Clause claim fails as a matter of law.

3. Federal Cigarette Labeling and Advertising Act

The Federal Cigarette Labeling and Advertising Act ("FCLAA"), 15 U.S.C. § 1331 *et seq.*, sets forth a comprehensive federal program to deal with cigarette labeling and advertising. Section 1334(b) provides: "No requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this chapter." 15 U.S.C. § 1334(b). In Count II of the Complaint, Plaintiffs contend that the MSA and Escrow Statute are preempted by the FCLAA. Federal law supersedes state law when Congress expressly states an intention to pre-empt state law, or when a federal regulatory scheme is sufficiently comprehensive so as to imply congressional intent to preoccupy the entire field. Hillsborough County, Fla. v. Automated Medical Laboratories, Inc., 471 U.S. 707,713,105 S.Ct. 2371,2375,85 L.Ed.2d 714 (1985) (citing Jones v. Rath Packing Co., 430 U.S. 519, 525, 97 S.Ct. 1305, 1309, 51 L.Ed.2d 604 (1977); Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947)). Plaintiffs claim the Settling States and PMs, through the MSA, have created a national regulatory scheme on the advertising and marketing of cigarettes that violates and is preempted by the FCLAA. Because

the MSA prohibits many forms of cigarette advertising, Plaintiffs argue Louisiana's Escrow Statute compels tobacco manufacturers to either join the MSA and thus restrict their advertising, or make substantial annual payments into escrow. [Doc. 1,¶75].

Despite Plaintiffs assertions, the Court is inclined to agree with the growing number of courts that have expressly rejected this argument. *See* Grand River Enterprises Six Nations, Ltd. v. Prior, 2003 WL 22232974, "16-17 (S.D.N.Y. 2003), aff'd in part, 425 F.3d 158 (2nd Cir. 2005); Omaha Tribe of Nebraska v. Miller, 311 F.Supp.2d 816,823-28 (S.D. Iowa 2004); PTI, Inc. v. Philip Morris, Inc., 100 F.Supp.2d 1179, 1204-06 (C.D. Cal. 2000). Louisiana's Escrow Statute requires tobacco product manufacturers to join the MSA or make an annual deposit into an escrow account to cover potential future liability. The statute does not in any way concern cigarette packaging, advertising, or promotion. "To the extent the plaintiffs object to the voluntary advertising restrictions to which the signatories to the [MSA] have agreed, they lack standing to challenge these provisions. Moreover, the restrictions are not legislatively required." Grand River Enterprises Six Nations, Ltd., 2003 WL 22232974, *I7 (citing PTI, Inc., 100 F.Supp.2d at 1205). In fact, Congress has refused to regulate the entire field of tobacco, "opting instead to create a distinct regulatory scheme focusing mainly on the labeling and advertising of tobacco products." Omaha Tribe of Nebraska, 31 1 F.Supp.2d at 823 (citing Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 137, 120 S.Ct. 1291, 1303, 146 L.Ed.2d 121 (2000)). As there is no indication that

Congress intended, either explicitly or implicitly, for the FCLAA to preempt the entire field of tobacco regulation, the Court concludes that the FCLAA does not preempt Louisiana's Escrow Statute. Thus, Plaintiff's FCLAA preemption claim fails as a matter of law.

4. Commerce Clause and Due Process Clause

Count III of the Plaintiff's Complaint alleges that the MSA violates the Commerce Clause and Due Process Clause by regulating interstate commerce in an extraterritorial fashion. [Doc. 1, ¶ 791. Plaintiffs similarly allege that Louisiana's Escrow Statute is unconstitutional under the Commerce Clause and Due Process Clause because of its extraterritorial reach. at 81. As with Plaintiffs' other claims, these arguments have been repeatedly rejected by other courts in cases challenging the MSA and its Qualifying Statutes.

1. Commerce Clause

The Commerce Clause gives Congress the power "[tlo regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. Art. I, § 8, cl. 3. While the Commerce Clause is more frequently invoked as authority for federal legislation, there is also a dormant or negative aspect of the Clause that limits the power of States to enact legislation that adversely affects interstate commerce. *See* Hughes v. Oklahoma, 441 U.S. 322, 326,99 S.Ct. 1727,60 L.Ed.2d 250 (1979); Piazza's Seafood World, LLC v. Odum, 448 F.3d 744,750 (5th Cir. 2006). The dormant Commerce Clause's limitation on State power, however, "is by no means absolute." Lewis v. BT Investment Mgrs., Inc.,

447 U.S. 27, 36, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980). In the absence of conflicting federal legislation, the States retain authority under their general police powers to regulate matters relating to the health, life, and safety of their citizens, even though interstate commerce may be affected. Id.; Huron Portland Cement Co. v. City of Detroit, Mich., 362 U.S. 440, 443-44, 80 S.Ct. 81 3, 81 6, 4 L.Ed.2d 852 (1 960).

To determine whether a state statute violates the dormant Commerce Clause, the court conducts a two-tiered analysis. First, the court must determine whether the state statute facially discriminates against interstate commerce. Oregon Waste Sys., Inc. v. Dept. of Environmental Quality, 51 1 U.S. 93, 99, 114 S.Ct. 1345, 1350, 128 L.Ed.2d 13 (1994); Hughes, 441 U.S. at 336, 99 S.Ct. at 1736. In this context, "'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually *per* se invalid." Id. Second, if the regulation has only an "incidental effect" on interstate commerce, the Court must applying the balancing test derived from Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970). A nondiscriminatory regulation will generally be upheld unless "the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." Id., 397 U.S. at 142, 90 S.Ct. at 847. "If a legitimate local purpose is found, ... the question becomes one of degree." Id. "[Tlhe extent of the burden that will be tolerated will of course depend on the nature of the lo-

cal interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." Id.

Plaintiffs allege that the MSA and the Escrow Statute directly regulate interstate commerce because the PM's payments under the MSA are based on the national market share and the Escrow Statute directly links escrow payments to MSA payments. [Doc. 1, ¶ 79; Doc. 111] . This argument is unavailing. Louisiana's Escrow Statute requires that NPMs pay into an escrow account a certain amount based on a rate "per unit sold," which is defined as "the number of individual cigarettes sold in the state" by the NPM. La. R.S. §§ 13:5062(1O), 5063(C). But the statute makes no distinction based on cigarette origin; rather, the requirement applies equally to in-state, out-of-state, and foreign tobacco manufacturers. *See* Star Scientific, Inc. v. Beales, 278 F.3d 339, 356 (4th Cir. 2002); Grand River Enterprises Six Nations, Ltd. v. Prior, 425 F.3d 158, 169 (2nd Cir. 2005); PTI Morris, Inc. v. Philip Morris, Inc., 100 F.Supp.2d 1179, 1201 (C.D.Cal. 2000).

Plaintiffs also allege that the Escrow Statute imposes a burden on interstate commerce that is clearly excessive in relation to any putative local benefits because the statute mandates the collection of escrow payments from NPMs, regardless of whether they are located in, or sell cigarettes in, Louisiana, if their cigarettes ultimately end up in Louisiana. [Doc. 1, ¶81; Doc. 111] . Louisiana's Escrow statute serves the legitimate state interest of ensuring that the state has a source of funds available to provide medical care to persons with smoking-related health conditions from

those tobacco manufacturers who are not members of the MSA and, thus, are not already compensating the state for these costs. The statute also prevents tobacco manufacturers who were not members of the MSA from earning quick, large profits and then becoming judgment proof before being sued by the State. *See* La. R.S. § 13:5061; Star Scientific, 278 F.3d at 257. Nevertheless, Plaintiffs argue an unreasonable "burden" is imposed on NPMs to monitor distributors and the number of cigarettes distributed to the state because the escrow payment is based on all cigarettes sold in Louisiana, whether directly or indirectly through a distributor. But as the Magistrate Judge previously pointed out:

> [A] manufacturer should be able to contractually obligate those who purchase cigarettes from it to distribute the cigarettes only for sale in particular states. Furthermore, if the manufacturer has not filed the proper certificates to have a particular brand approved for sale in Louisiana, it is illegal for a distributor to sell that brand in the state. Louisiana law, La. R.S. 13:5073(C), makes it unlawful for "any person" to sell a brand or affix a stamp to a package of a brand that has not been properly certified by the manufacturer and approved by the state. These rules reduce the alleged burden that manufacturers have to monitor the stream of their products.

[Doc. 43]; see also, Star Scientific, 278 F.3d at 357 (recognizing that because distributors in Virginia were already required to record the number of cigarettes they stamp with the Virginia excise stamp and

report that information to the state, "any additional burden caused by requiring manufacturers to obtain this information from the distributors is minimal.").

Considering the important state interests advanced by Louisiana's Escrow Statute and the minimal burden placed on interstate commerce by its operation, the Court concludes that the burden on interstate commerce is not clearly excessive when compared to the significant local benefits. Accordingly, Plaintiffs' Commerce Clause claim fails as a matter of law.

2. Due Process Clause

Plaintiffs include with their Commerce Clause claim a similar Due Process Clause claim based on the alleged extraterritorial reach of the MSA and Louisiana's Escrow Statute. As discussed above, the Escrow Statute imposes escrow requirements on NPMs, regardless of whether or not their cigarettes are sold in the state directly or indirectly through a distributor. But there is no evidence that Plaintiffs' have been required to make escrow payments on account of cigarettes that have been sold without their knowledge of consent. To the contrary, as a result of Louisiana's Complementary Legislation, see supra, an NPM's cigarettes may not be lawfully sold in Louisiana unless the NPM has taken affirmative steps to have its cigarettes certified for sale in the state. *See* La. R.S. § 13:5073(C). Thus, because any due process challenge that might be made by a NPM would be frivolous, Plaintiffs' Due Process claim lacks merit.

CONCLUSION

Accordingly, the Court concludes that there are no genuine issues of material fact remaining and that

Plaintiff's challenges to the MSA and Louisiana's Escrow Statute fail as a matter of law. Therefore, the Attorney General's Motion for Summary Judgment [Record Document 87] is **GRANTED,** and the Plaintiffs' Motion for Summary Judgment [Record Document 95] is **DENIED.** All claims by Plaintiffs are **DISMISSED WITH PREJUDICE.**

THUS DONE AND SIGNED in Shreveport, Louisiana, this 24th day of September, 2009.

s/ S. Maurice Hicks, Jr.

S. MAURICE HICKS, JR.
UNITED STATES DISTRICT JUDGE

No. 10-622

In the Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE #1, AND MARK HEACOCK,

Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

JAMES D. "BUDDY" CALDWELL
Louisiana Attorney General
JAMES TREY PHILLIPS
First Assistant Attorney General
S. KYLE DUNCAN*
Appellate Chief
LOUISIANA DEPARTMENT OF JUSTICE
P.O. Box 94005
Baton Rouge, LA 70804-9005
(225) 326-6716 (tel.)
DuncanK@ag.state.la.us

Counsel for Respondent
*Counsel of Record

January 24, 2011

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

QUESTIONS PRESENTED

1. Whether this Court should grant a petition for certiorari to consider the applicability of *Parker v. Brown* state-action immunity to the Master Settlement Agreement ("MSA") among 46 states and various tobacco companies, even though the courts of appeals have uniformly held that the MSA and related legislation are not subject to challenge under the antitrust laws, and even though the issue of *Parker* immunity was neither properly raised in nor decided by the court below.

2. Whether this Court should grant a petition for certiorari to review the ruling of the court below that the MSA does not violate the Compact Clause of the United States Constitution, Art. I, § 10, cl. 3, even though that ruling expressly applied the controlling decisions of this Court and reached the same result as every other court that has considered a Compact Clause challenge to the MSA.

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INTRODUCTION

This case is the latest in a long series of challenges to the 1998 tobacco Master Settlement Agreement ("MSA") and the legislation that the 46 states that are parties to that Agreement ("Settling States") have enacted to implement it. More than twenty such challenges have been brought in federal court, and all have been rejected. In six of those cases, this Court has denied petitions for certiorari premised on the same statutory or constitutional provisions – the Sherman Act and the Compact Clause – that are the basis of the instant Petition. The Petition provides no reason why the Court should review this consistent and settled jurisprudence.

The MSA is a "landmark agreement," *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001), that addresses "tobacco use, particularly among children and adolescents," which this Court has recognized as posing "perhaps the single most significant threat to public health in the United States." *Id.* at 570 (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000)). The Agreement was signed by the Attorneys General of 46 Settling States. It was thereafter endorsed by the legislatures of those States, all of which have enacted legislation to implement it. The Agreement was also expressly "approved in all respects" by courts in each of the Settling States, all of which found that "entering into this settlement is in the best interests of the State." *See, e.g.*, *Ieyoub ex rel. Louisiana v. American Tobacco Co.*, No. 96-1209 (Dec. 11, 1998, 14th Judicial District, Calcasieu

Parish). In addition, Congress has recognized the existence of the MSA, approving the states' use of MSA payments "for any expenditures determined appropriate by the State[s]." 42 U.S.C. §1396b(d)(3)(B).

As Petitioners acknowledge, Pet. 35, there is no circuit conflict on either issue raised in the Petition. Petitioners assert instead that the courts below erred. Their arguments, however, rest on allegations about the MSA's effects that the courts below rejected based on the undisputed facts contained in a summary judgment record. The rulings below expressly follow longstanding precedents of this Court. Indeed, challenges to the MSA or to the actions of state officials enforcing MSA-related legislation have been rejected by the Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and D.C. Circuits.[1] Moreover, given the unique circumstances that led to the MSA, there is little prospect that the same issues will arise in the future, nor is there a need for the Court to exercise its supervisory powers.

For these reasons, the Petition, like the many similar petitions that have come before, should be denied.

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[1] In addition to the decision below and those cited *infra* on page 18, *see Freedom Holdings, Inc. v. Cuomo*, 624 F.3d 38 (2d Cir. 2010); *KT&G Corp. v. Attorney Gen. of State of Oklahoma*, 535 F.3d 1114 (10th Cir. 2008); *Tritent Int'l Corp. v. Kentucky*, 467 F.3d 547 (6th Cir. 2006); *North American Trading Co. v. National Ass'n of Attorneys Gen.*, Civ. Action No. 01-01600 (D.D.C. Sept. 18, 2001), *aff'd*, No. 01-7173 (D.C. Cir. Nov. 25, 2002).

STATEMENT

A. The Master Settlement Agreement and Escrow Statutes

1. Beginning in the mid-1990s, a large number of states, including Louisiana, sued the major cigarette manufacturers on a number of legal theories, seeking to recover the Medicaid costs and other damages they had incurred as a result of smoking-related disease. In 1997, the states and major tobacco manufacturers agreed on a proposed settlement whose implementation was conditioned on the enactment of federal legislation. This legislation failed to be enacted, which led to further negotiations that culminated in the MSA.

Petitioners claim that the 1997 proposed settlement was "similar to the MSA in most relevant respects," and suggest that because that settlement required federal legislation to be implemented, the MSA must be legally deficient because Congress did not enact or approve it. Pet. 10-11, 30-31.[2] Petitioners also suggest that the Federal Trade Commission's criticisms of the 1997 proposed settlement as having potentially anti-competitive consequences apply equally to the MSA. In fact, however, the 1997 proposed settlement was different in many respects from the MSA. Among other things, it would have limited the tobacco companies' future liability in actions brought by private parties and would have given the Food and Drug

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[2] As discussed *infra* at 33-35, Congress did in fact consent to the MSA.

Administration broad authority to regulate tobacco products. S.1415, 105th Cong., 1st Sess. Moreover, the FTC's criticism was addressed to a provision of the settlement that would have expressly allowed the tobacco companies to "jointly confer, coordinate, or act in concert" to achieve the goals of the settlement, which the Commission was concerned would have conferred on the tobacco companies "a broad degree of immunity from the antitrust laws," and had "the potential to reduce competition and enhance the ability of the cigarette companies to 'coordinate' price increases." FTC, *Competition and the Financial Impact of the Proposed Tobacco Settlement* (September 1997), at ii, A-2. The MSA, in contrast, in no way authorizes the companies that have signed it to confer, coordinate, or act in concert, nor is there anything in the MSA or elsewhere purporting to exempt them from antitrust liability for any action taken before or after the MSA went into effect.

2. After further negotiations among representatives of the states and major tobacco companies following the failure of the 1997 proposed settlement, the MSA was made available for signature by any state that wished to sign it. Forty-six states and six other governmental jurisdictions, which are collectively referred to in the MSA as the "Settling States," did so. As noted above, courts in all Settling States subsequently found the MSA to be in the "best interests" of the state and "approved [it] in all respects." (Four states (Florida, Minnesota, Mississippi, and Texas) had earlier entered into separate settlements with the major tobacco companies – settlements whose provisions do not

differ from those of the MSA in any material respects.) The manufacturers that agree to the MSA are referred to as "Participating Manufacturers," or "PMs." Those manufacturers that settled pursuant to the MSA as of its execution date are referred to as "Original Participating Manufacturers" ("OPMs"), while those manufacturers that have since settled are referred to as "Subsequent Participating Manufacturers" ("SPMs").

The MSA's objectives were to resolve the states' tobacco litigation while addressing the states' public health concerns regarding tobacco use, particularly by youth. To achieve these objectives, the MSA settled and released the states' past and future claims against the Participating Manufacturers. In exchange, the OPMs agreed to make billions of dollars in Initial Payments to the Settling States over the MSA's first five years. MSA §IX(b). And all PMs – not only the OPMs – agreed to make billions of dollars more in Annual Payments to the Settling States each year in perpetuity and to restrict their advertising, marketing and promotional practices. MSA §§IX(c), III. The MSA significantly promotes public health in a variety of ways vital to reducing tobacco use, especially among minors. It does this through the marketing restrictions mentioned above, the establishment of a foundation dedicated to research and education regarding tobacco use prevention and cessation, and by the imposition of per-cigarette settlement costs that through ordinary market behavior are passed through in whole or part in the form of increases in the price of cigarettes.

The MSA has had a dramatic, positive impact on public health, and this will likely increase over time. Because most smokers begin to smoke by the time they reach the age of 19, reductions in youth smoking will almost certainly translate into reductions in smoking in the overall population. Indeed, because of the MSA and other measures, cigarette consumption declined 24% between 1997 and 2007. *Freedom Holdings, Inc. v. Cuomo*, 592 F.Supp.2d 684, 687 (S.D.N.Y. 2009), *aff'd*, 624 F.3d 38 (2d Cir. 2010). These consumption declines will, in turn, lead to a substantial reduction in death and disease caused by smoking and will have a beneficial impact on the finances of the Settling States as the costs of medical care for – and the productivity losses resulting from – smoking-related diseases also decline.

The PMs' payments under the MSA are non-discretionary and are calculated according to precise formulas tied to the number of cigarettes each PM sells in a given year, reflecting the fact that the harm the manufacturer's cigarettes cause will vary depending on how many of its cigarettes are consumed. PM per-cigarette payments do not vary with PMs' market share. Nothing in the MSA or any state statute authorizes or requires the PMs to take any action – joint or otherwise – with respect to prices or output, nor does any provision limit any cigarette manufacturer's freedom to set its own prices and output. To date, the Settling States have received approximately $74.7 billion pursuant to the MSA, of which Louisiana's share has been about $1.7 billion.

3. Each MSA Settling State has enacted an "Escrow Statute" that requires every cigarette manufacturer either: (a) to become a Participating Manufacturer and generally perform its financial obligations under the MSA, or (b) if it remains a Non-Participating Manufacturer ("NPM"), to deposit a specified amount into an escrow account for every cigarette it sells in the state. *See, e.g.*, La. R.S. §13:5063. NPMs do not make payments to the Settling States, nor are they bound by the MSA's marketing restrictions. Under a state's Escrow Statute, the amount an NPM must deposit in escrow is a statutorily specified amount for each of the NPM's cigarettes sold in that state and is guaranteed not to exceed what the NPM would have to pay under the MSA on account of its sale of those same cigarettes if it were to settle with the Settling States as a PM. *Id.* §13.5063(A), (C)(2)(b). Escrow deposits may be withdrawn to pay a tobacco-related liability or settlement to the state. To the extent they are not so used, they are released to the NPM after 25 years. In the meantime, the NPM receives interest on the account as it is earned. *Id.* §13.5063(C)(2)(c). The Louisiana statute addresses the concern that non-settling manufacturers would likely be judgment-proof absent the escrowed funds, and reflects the legislature's judgment that "[i]t is the policy of this state that financial burdens imposed on the state by cigarette smoking be borne by tobacco product manufacturers rather than by the state to the extent that such manufacturers either determine to enter into a settlement with the state or are found culpable by the courts." *Id.* §13.5061(4). The statute thus provides Louisiana with security

for potential liabilities of NPMs while significantly reducing what would otherwise be a "free rider" MSA-related cost advantage for NPMs. *Id.* §13.5061(6).

Notwithstanding the escrow requirement, the MSA has provided an enormous opportunity for existing tobacco companies that chose to remain NPMs, such as Petitioner S&M Brands, as well as new entrants into the United States cigarette market that do not wish to become PMs. As the district court found in *Freedom Holdings*, NPMs had a total market share of 0.5% in 1998, when the MSA was signed. That share mushroomed to 8.1% in 2003, assisted in part by shortcomings in the Escrow Statute. Even after those shortcomings were remedied, NPMs' total market share was 5.4% in 2007, or more than ten times their 1998 share. 592 F. Supp. 2d at 691-92. (A significant portion of the reduction in NPM market share from 2003 to 2007 occurred because a large NPM became an SPM in 2004. *Id.* at 691 n.5.)

B. Petitioners' "Interstate Cartel" Allegations

Petitioners assert as fact their own unproven and unfounded allegation that "the MSA set up an interstate cartel enabling" the tobacco companies "to charge monopoly prices and recover their MSA costs, plus hefty additional profits, from consumers without fear of price competition among themselves or from non-participating cigarette manufacturers." Pet. 4. None of the arguments made in support of that allegation survives scrutiny, and none has resulted in any court finding that the MSA or its

implementing legislation violates – or is inconsistent with – the Sherman Act.[3]

1. According to Petitioners, the MSA "discourages price competition for market share by allocating the costs of the MSA among the Majors [OPMs] in proportion to their *current* national market share of cigarette sales." *Id.* (emphasis in original). Allocation of payments based on market share, however, simply means that each OPM pays the same amount to the Settling States for each cigarette it sells – *i.e.*, the MSA payment obligation imposes a flat per-cigarette cost that is the same for each OPM. Such an allocation creates no more disincentive for an OPM to compete based on price or to gain market share than does an excise tax, because each OPM pays the same per-cigarette amount no matter how large or small its market share.[4]

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[3] Petitioner claims that the Second Circuit, in *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2d Cir. 2004), "recognized that . . . 'the MSA' is an 'express market sharing agreement' . . . ." Pet. 16-17. As the Second Circuit itself later explained, however, it was "[a]ccepting plaintiffs' allegations as true, as we were required to do in reviewing a judgment of dismissal." *Freedom Holdings, Inc. v. Cuomo*, 624 F.3d at 45. On remand, the district court, like every other court to consider those allegations, rejected them and entered judgment for the state. *Freedom Holdings, Inc. v. Cuomo*, 592 F.Supp.2d 684 (S.D.N.Y. 2009), *aff'd on other grounds*, 624 F.3d 38 (2d Cir. 2010).

[4] In general, each OPM pays an amount calculated by multiplying its share of OPM volume (expressed as a percentage) times the OPMs' total payment. MSA §IX(c). The total payment is adjusted each year for changes in total OPM

Petitioners further allege that the MSA "discourages price competition and divides the market" among SPMs that signed the MSA within 90 days of its execution date. Pet. 5. These "grandfathered SPMs" are obligated to make MSA payments only to the extent that their sales exceed the higher of their 1998 market share or 125% of their 1997 market share. MSA §IX(i)(1), (4). According to Petitioners, this means that to the extent grandfathered SPMs exceed their grandfathered market shares, they "are penalized by having to make MSA payments on excess sales." Pet. 5. Grandfathered SPMs, however, have lower average costs than do other PMs because the grandfathered portion of their sales is exempted from MSA payments. Moreover, once their sales exceed their grandfathered market shares, their per-cigarette marginal costs are no greater than those of other PMs. Accordingly, SPMs are in no way "penalized" for engaging in price competition and gaining market share, nor does the MSA in any way "divide the market."

Petitioners also state that the MSA "stabilizes prices and limits price competition from all other manufacturers joining the MSA after 90 days by imposing annual MSA payments on those manufacturers based on their entire national market share" that are larger than the per-cigarette payments required to be made by OPMs. Pet. 5.

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volume, *id.* Exhibit E, which keeps each OPM's per-cigarette payment constant from year to year. Payments are also adjusted for inflation.

Petitioners are correct to the extent that OPMs receive a "Previously Settled States Reduction" (currently about 12.24% of their MSA payments), whereas SPMs do not. MSA §§II(kk), IX(c)(1). This Reduction, however, only partially offsets the settlement payments the OPMs make to the four states that settled separately with them, and thus operates like a partial tax credit for those other payments. The SPMs, however, did not settle with those states and thus receive no credit. In the aggregate, each OPM actually pays somewhat more for each cigarette it sells anywhere in the United States than do later-signing SPMs, which are not inhibited in their ability to compete on price.

2. In support of their "interstate cartel" characterization, Petitioners also contend that the MSA restrains competition "by forbidding numerous forms of advertising, as well as lobbying and litigation adverse to the MSA," and that many of these restrictions apply nationwide. Pet. 5. The MSA, however, is a settlement of litigation that included allegations of unlawful advertising in violation of state laws. For example, Louisiana's lawsuit against the major tobacco companies alleged, among other things, that "[f]or many years the defendants have engaged in a vast misleading promotional, public relations, and lobbying campaign that has as its chief goal increasing the number of persons addicted to tobacco products and decreasing the number of persons who attempt or succeed in quitting." *Ieyoub ex rel. Louisiana v. American Tobacco Co.*, No. 96-1209 (Mar. 12, 1996 14th Judicial District, Calcasieu Parish), Petition ¶ 61. The restrictions in Section III of the Agreement,

which settled those allegations and similar allegations by other states, are akin to an assurance of voluntary compliance following settlement of a consumer fraud complaint. They do not prohibit advertising generally nor is their purpose to divide markets, unlike the restrictions in *Blackburn v. Sweeney*, 53 F.3d 825 (7th Cir. 1995), Pet. 16. Moreover, each Settling State can enforce these restrictions only against violations in its own territory. MSA § VII(c).

3. Petitioners also allege that the MSA "stabilizes prices and limits price competition from" NPMs "by requiring member States to enact" Escrow Statutes "compelling NPMs to pay into escrow each year an amount equal to or greater than the MSA payments on comparable sales." Pet. 5-6. States are not required to enact Escrow Statutes, although the MSA creates a strong economic incentive for them to do so. Each Settling State's Escrow Statute "establishes a state regulatory scheme that does not require or allow any input from private parties." *Xcaliber Int'l Ltd. LLC v. Caldwell*, 612 F.3d 368, 376-77 (5th Cir. 2010). Unlike *National Electrical Contractors Ass'n, Inc. v. National Constructors Ass'n*, 678 F.2d 492 (4th Cir. 1982), Pet. 16 n.9, therefore, this is not a situation in which private parties have entered into an agreement to impose costs on competitors; those costs are imposed by statute by the states.

The stated goal of the Escrow Statutes is to "effectively and fully neutralize[] the cost disadvantages that the Participating Manufacturers experience *vis-à-vis* Non-Participating

Manufacturers within . . . [each] Settling State as a result of" the MSA's provisions. MSA §IX(d)(2)(E). As noted above, the Statutes expressly provide that an NPM cannot be required to pay more into escrow than it would have paid under the MSA for the same cigarettes had it signed the MSA as an SPM, including any downward adjustment to which such an SPM would have been entitled. *See, e.g.*, La. R.S. §13.5063(C)(2)(b). As the Second Circuit has held, the Statutes "can be analogized to the imposition of a flat tax . . . whose only arguably 'anti-competitive' effect is to raise cigarette prices," and they otherwise allow "normal market mechanisms [to] function." *Freedom Holdings, Inc. v. Cuomo*, 624 F.3d at 56, 59, 62 (2d Cir. 2010).

4. Experience under the MSA has confirmed the foregoing conclusions. As the *Freedom Holdings* district court found after examining the evidence in that case, "[t]he updated reports reveal that the payment structure of the MSA does not favor the major cigarette companies over those companies that either did not join the MSA, or joined the MSA at some later date." 592 F. Supp. 2d at 691. The MSA and Escrow Statutes have internalized in the price of the cigarette manufacturers' products a portion of the social costs of the death and disease caused by smoking, but there is no evidence – and no court has found – that they have permitted or authorized any cigarette manufacturer to fix prices, limit output, divide markets or charge monopoly prices, or that they have discouraged price competition.[5]

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[5] *Amici* Constitutional Law Scholars and Antitrust Law Professors uncritically accept Petitioners' allegations as true,

C. The Proceedings Below

1. Petitioners' complaint, filed August 2, 2005, pleaded several constitutional theories in support of their claim that the Louisiana Attorney General should be enjoined from enforcing the MSA and the Louisiana Escrow Statute. Count I alleged a violation of the Compact Clause. Although as part of their Compact Clause count Petitioners alleged that "[t]he MSA and its Qualifying Statute encroach upon federal supremacy by patently violating the federal antitrust laws, including the Sherman Act," Complaint ¶ 62, there was no separate Sherman Act-based count. Nor did Petitioners plead as a basis for the district court's jurisdiction a claim brought under the antitrust laws. *See* 15 U.S.C. §15(a).

The Louisiana Attorney General filed a motion to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6) on November 2, 2005. The motion was referred to a Magistrate Judge, who issued his Report on September 5, 2006, recommending that the complaint be dismissed in its entirety. In doing so, the Magistrate Judge observed that "[i]f the MSA actually violates antitrust laws, . . . a party with proper standing may bring a suit under those laws to enforce them. But the potential for such claims does

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apparently without having any familiarity with the summary judgment record in this case or even the numerous judicial decisions rejecting those allegations. For their part, *amici* Freedom Holdings, Inc. and International Tobacco Partners Ltd. simply repeat some of the same arguments they made in their own unsuccessful antitrust challenge to the MSA. *Freedom Holdings, Inc. v. Cuomo*, 592 F.Supp.2d 684 (S.D.N.Y. 2009), *aff'd on other grounds*, 624 F.3d 38 (2d Cir. 2010).

not require the court to annul the MSA as a violation of the Compact Clause." Report at 20-21. Petitioners filed objections to the Magistrate's Report but did not contend that their antitrust allegations formed the basis for a claim separate from their Compact Clause claim. On November 9, 2006, the district court issued an order stating that it was "inclined to agree with the reasoning" of the Magistrate Judge's Report, but that it was "constrained by" the Fifth Circuit's reversal of the grant of a motion to dismiss similar claims in *Xcaliber International Ltd. LLC. v. Foti*, 442 F.3d 233 (5th Cir. 2006). Accordingly, the district court accepted the Magistrate Judge's recommendation to dismiss the complaint only as to Petitioners' Tenth Amendment claim. Petitioners did not amend their complaint to plead a separate antitrust claim, although they could have done so as of right under Fed. R. Civ. P. 15(a).

2. After Petitioners conducted substantial discovery directed to the Louisiana Attorney General and the National Association of Attorneys General, the parties filed cross motions for summary judgment. On September 24, 2009, the district court granted the Louisiana Attorney General's motion for summary judgment and denied Petitioners' motion for summary judgment. The court held that the Compact Clause claim "fails as a matter of law," Pet. App. B15, because there is no "actual or potential encroachment or interference" with federal supremacy, *id.* B13. The court went on to find that even if congressional consent were required, "Congress has plainly provided it" when it amended the Medicaid statute in 1999 "and disclaimed any

federal interest in the moneys received by the Settling States pursuant to the Agreement." *Id.* B14. *See* 42 U.S.C. §1396b(d)(3)(B)(i-ii). The court did not address Petitioners' antitrust contentions as a separate claim, but instead treated them as one element of Petitioners' Compact Clause claim, consistently with the treatment of those contentions in Petitioners' complaint and in the earlier Magistrate Judge's Report. In a footnote in its opinion, the district court addressed Petitioners' Compact Clause "antitrust policy" argument by summarizing the opinions of other courts that had previously rejected claims that the MSA or related statutes are preempted under the antitrust laws, but the court had no occasion to address the issue of state-action immunity under *Parker v. Brown*, 317 U.S. 341 (1943), and did not do so. Pet. App. B10 n.7.

3. The Fifth Circuit affirmed unanimously on August 10, 2010. *First*, applying the test in this Court's decision in *United States Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978), the Fifth Circuit held that the MSA did not require congressional consent under the Compact Clause for the same reasons that the Fourth Circuit had earlier reached the same conclusion in *Star Scientific, Inc. v. Beales*, 278 F.3d 339 (4th Cir.), *cert. denied sub nom. Star Scientific, Inc. v. Kilgore*, 537 U.S. 818 (2002). Pet. App. A5-7. The court did not address the district court's additional finding that, if congressional consent were required, Congress had provided it.

Second, the Fifth Circuit noted that – insofar as it related to the Escrow Statute – any antitrust challenge was foreclosed by its earlier decision in *Xcaliber International Ltd. v. Caldwell*, 612 F.3d 368 (5th Cir. 2010). Pet. App. A8. Recognizing, however, that *Xcaliber* had involved a challenge only to the Escrow Statute, the Fifth Circuit went on to consider "whether the MSA and Escrow Statute working together create an antitrust violation." *Id.*

The Fifth Circuit began its analysis by noting that "[w]hether the MSA and Escrow Statute violate federal antitrust laws has been addressed by the Sixth, Eighth, and Ninth Circuits, and all of those courts have rejected the plaintiffs' arguments." *Id.* The court then quoted from the Sixth Circuit's decision in *Trident International Corp. v. Kentucky*, which it said "aptly described the argument the present plaintiffs raise and why it must be rejected." *Id.* A9. In *Trident*, the plaintiffs had alleged that the Kentucky Escrow Statute was inconsistent with – and hence preempted by – the Sherman Act because it was "enacted by Kentucky to effectuate the provisions of the MSA [and] punishes NPMs and rewards SPMs – a practice that constitutes an 'illegal *per se* output cartel.'" 467 F.3d at 555. In affirming the grant of a motion to dismiss, the Sixth Circuit recognized that Sherman Act preemption arises only if Kentucky's Escrow Statute "'mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or . . . places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute.'" *Id.* at 554 (quoting *Rice v. Norman Williams Co.* 458 U.S. 654, 661 (1982)). The Sixth

Circuit then reasoned that because Kentucky "neither mandated nor explicitly authorized" the PMs to engage in *per se* violations of the antitrust laws following the MSA's execution, Tritent's argument on this issue was foreclosed. *Id.* at 557.

After quoting from the Sixth Circuit's decision in *Tritent*, the Fifth Circuit concluded:

> We agree with the Sixth Circuit and the other circuits that have already considered the issue of whether the MSA and Escrow Statute violate the Sherman Act, and we adopt their rationale. Accordingly, we find no merit to the plaintiffs [sic] arguments that the MSA and Escrow Statute violate federal antitrust laws.

Pet. App. A10.

REASONS FOR DENYING THE PETITION

The Petition should be denied, much like the twenty-some similar federal court challenges to the 1998 MSA that have preceded it and been unanimously rejected. In the 12 years since the MSA went into effect, this Court has denied *six* petitions for certiorari raising one or both of the issues now re-raised by Petitioners. *See Grand River Enter. Six Nations, Ltd. v. Beebe*, 574 F.3d 929 (8th Cir. 2009), *cert. denied sub nom. Grand River Enter. Six Nations, Ltd. v. McDaniel*, 130 S. Ct. 2095 (2010) (Sherman Act); *Sanders v. Brown*, 504 F.3d 903 (9th Cir. 2007), *cert. denied*, 553 U.S. 1031 (2008) (Sherman Act); *Mariana v. Fisher*, 338 F.3d 189 (3d Cir. 2003), *cert. denied sub nom. Mariana v. Pappert*, 540 U.S. 1179 (2004) (Sherman Act and Compact Clause standing); *Star Scientific, Inc. v. Beales*, 278

F.3d 339 (4th Cir.), *cert. denied sub nom. Star Scientific, Inc. v. Kilgore*, 537 U.S. 818 (2002) (Compact Clause); *A.D. Bedell Wholesale Co., Inc. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir. 2001), *cert. denied*, 534 U.S. 1081 (2002) (Sherman Act); *Hise v. Philip Morris Inc.*, 46 F. Supp.2d 1201 (N.D. Okla. 1999), *aff'd mem.*, 208 F.3d 226 (10th Cir.), *cert. denied*, 531 U.S. 959 (2000) (Sherman Act and Compact Clause). Nothing material has changed since this Court first declined to review these issues in 2000. No split of authority has developed. To the contrary, decisions rejecting legal challenges to the MSA have stacked up, and this Court has repeatedly denied certiorari. There is no reason for a different outcome here.

Indeed, this case is a uniquely poor vehicle for reviving Petitioners' claims against the MSA. The Fifth Circuit did not even reach the first purported "question presented." Pet. i. The Court of Appeals denied Petitioners' antitrust claim on an antecedent question and thus did not resolve the *Parker v. Brown* state-action immunity issue at all. And with respect to the Compact Clause question, Petitioners themselves concede that the Fifth Circuit merely "adopted" the Fourth Circuit's reasoning in *Star Scientific, Inc. v. Beales* rather than "[o]ffering . . . its own" analysis. Pet. 27. This Court, of course, declined to review *Star Scientific*'s reasoning nine years ago, and Petitioners point to no compelling reason why the Fifth Circuit's mere adoption of the Fourth Circuit's reasoning strengthens the case for certiorari. The Fourth Circuit's reasoning, in any event, was consistent with this Court's jurisprudence and correct. The Court should treat this Petition no

differently from the other petitions challenging the MSA that it has uniformly denied over the past decade.

I. THE ISSUE OF STATE-ACTION IMMUNITY WAS NOT RULED ON BY THE COURTS BELOW, AND IN ANY EVENT APPLYING SUCH IMMUNITY TO DEFEAT ANTITRUST CHALLENGES TO THE MSA WOULD BE ENTIRELY CONSISTENT WITH THIS COURT'S DECISION IN *PARKER V. BROWN* AND THE DECISIONS OF OTHER APPEALS COURTS.

1. Petitioners contend that the Court should grant their Petition because the Fifth Circuit incorrectly applied the state-action immunity doctrine of *Parker v. Brown*. The *Parker* immunity issue was not properly raised below, however, and the Fifth Circuit did not address or decide it. There is no warrant for this Court to resolve an issue never resolved below, and the Petition's efforts to obtain this Court's review on a purely academic question only underscore the absence of any necessity for this Court's review.

Indeed, the Fifth Circuit's sole mention of *Parker* came in describing the *second* step of petitioners' two-step antitrust claim. *See* Pet. App. A7 ("The plaintiffs . . . argue that the MSA and Escrow Statute are *per se* violations of the Sherman Act . . . . The plaintiffs further assert that the only defense *potentially* available to the Attorney General is the implied state-action immunity found under *Parker v. Brown*.") (emphasis added). The Fifth Circuit set out to address "whether the MSA and Escrow Statute working together create an antitrust violation," *id.* A8, and concluded that there was "no merit to the

plaintiffs [sic] arguments that the MSA and Escrow Statute violate federal antitrust laws." *Id.* A10. As it found no Sherman Act violation, it saw no need to consider the "potential[]" *Parker* "defense" to a violation that did not exist. Pet. App. A7; *see also Fisher v. City of Berkeley*, 475 U.S. 260, 270 (1986) (having found that municipal ordinance is not inconsistent with the antitrust laws, Court "need not address whether, even if the controls were to mandate §1 violations, they would be exempt under the state-action doctrine from antitrust scrutiny.").

The Fifth Circuit's reliance on the Sixth Circuit's decision in *Trident International Corp. v. Kentucky* underscores that it did not reach the *Parker* immunity issue. The Fifth Circuit quoted an entire paragraph from *Trident* in which the Sixth Circuit reasoned that Kentucky had "neither mandated nor explicitly authorized" the PMs to engage in *per se* violations of the antitrust laws following the MSA's execution. Pet. App. A9-10 (quoting *Trident*, 467 F.3d at 557). That quoted paragraph in the *Trident* opinion came right before the Sixth Circuit stated, in no uncertain terms, that "[b]ecause Trident has failed to satisfy the first prong of Sherman Act preemption analysis, *we need not consider the second prong's Parker state-action immunity doctrine*." *Id.* at 558 (emphasis added).[6] Like the Sixth Circuit,

[6] Similarly, the Fifth Circuit's reliance on the Eighth Circuit's decision in *Grand River Enter. Six Nations, Ltd. v. Beebe*, 574 F.3d at 936-38, and the Ninth Circuit's decision in *Sanders v. Brown*, 504 F.3d at 908-11, was limited to the portions of those decisions that held there was no *per se* violation of the Sherman Act, and did not include their subsequent discussions of state-action immunity

the Fifth Circuit was thus crystal clear in rejecting Petitioners' antitrust arguments based on its examination of the effects of the MSA and Escrow Statute on competition – without even reaching the issue of *Parker* state-action immunity.

Accordingly, Petitioners have it exactly backwards when they assert that "the court did not dispute the unchallenged proposition that the MSA itself was an agreement in restraint of trade and a *per se* violation of the Sherman Act," and "addressed only whether defendant was entitled to invoke 'state-action' immunity as originally set forth in this Court's decision in" *Parker*. Pet. 12; *see also id.* 17 ("The Fifth Circuit's sole basis for declining to apply the Sherman Act to the MSA was the state-action immunity defense . . . in *Parker*"). In reality, the Fifth Circuit addressed only the first, antecedent question of whether the MSA was a violation of the Sherman Act – a proposition, for that matter, which went far from "unchallenged."

It is well-established that this Court "do[es] not decide in the first instance issues not decided below.'" *Fitzgerald v. Barnstable Sch. Comm.*, 555 U.S. 246, ___, 129 S.Ct. 788, 798 (2009) (quoting *National Collegiate Athletic Ass'n. v. Smith*, 525 U.S. 459, 470 (1999)). That prudential rule applies even when the issues may well pique the curiosity of the professoriate. The primary issue in the Petition is an entirely academic question about the contours of *Parker* immunity that is nowhere discussed and nowhere raised by the decision below.

2. Petitioners try to create the impression that the *Parker* immunity issue is relevant by treating

the validity of their antitrust claim as a foregone conclusion. *See, e.g.*, Pet. 12 ("unchallenged proposition that the MSA itself was an agreement in restraint of trade"); *id.* 18 ("an admittedly *per se* illegal agreement between private parties"). As discussed above in the Statement, however, Petitioners' allegations concerning the effect of the MSA on competition do not comport with the facts and have been rejected by every court that has considered similar allegations. As a result, these courts have held that the MSA does not mandate or authorize private or hybrid[7] *per se* violations of the antitrust laws in all cases. *See, e.g., Grand River Enterprises Six Nations, Ltd. v. Beebe*, 574 F.3d at 938-39; *Sanders v. Brown*, 504 F.3d at 919; *KT&G Corp. v. Attorney General of State of Oklahoma*, 535 F.3d at 1132; *Freedom Holdings, Inc. v. Cuomo*, 592 F.Supp.2d at 696.

3. Even if this Court were inclined to consider for the first time in this litigation the state-action immunity issue that Petitioners attempt to raise, it should deny the Petition. Petitioners point to no conflict among the circuits on the applicability of *Parker v. Brown* to state action like that of the predecessor of Respondent Attorney General of Louisiana in signing the MSA on behalf of his state, including the cases in which the MSA itself has been

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[7] A hybrid restraint of trade arises when a state grants a private party "a degree of private regulatory power" that allows that party to compel other private actors to follow its pricing or other "private marketing decisions." *Fisher v. City of Berkeley*, 475 U.S. at 267-68.

at issue.[8] Moreover, the question whether *Parker* immunity applies to an agreement that simply provided a common framework for settling litigation between multiple states and private companies has not previously arisen in any other context. Nor, in view of the unique character of the MSA, is it likely to arise in the future. Petitioners do not urge the contrary. Rather, because Petitioners view the MSA as an "abomination," Pet. 37, they ask the Court to single it out for examination and "to offer an authoritative and definitive evaluation of that scheme" in light of federal antitrust law and the Compact Clause, *id.* 37-38 – an evaluation that is unlikely to have any significance beyond the context of the MSA, or within it for that matter.

4. Finally, Petitioners' contention that *Parker v. Brown* immunity should for the first time be held limited in application to actions by a single state that have effects only within that state, Pet. 19-20, has no basis in authority or logic. Even the *Parker* decision itself involved an alleged multi-state restraint – a California program that eliminated price competition among raisin producers, 95 percent

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[8] *Amici* Antitrust Law Professors assert that a conflict exists among circuits concerning the relationship among *Hoover v. Ronwin*, 466 U.S. 558 (1984), *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), and *Rice v. Norman Williams Co.*, as applied to the antitrust implications of the MSA. Brief at 6-7. No such conflict exists, however, and no court—including the Fifth Circuit in this case—has shown any confusion in applying those precedents. In any case, even if it were otherwise, this case would not be an appropriate vehicle for clarifying the interaction between *Midcal* and *Rice* because the decision below did not address those decisions.

of whose crop was sold in, and had a "substantial effect on," interstate and foreign commerce. 317 U.S. at 359. Moreover, the *Parker* Court relied on the statutory language as well as "the purpose, the subject matter, the context and the legislative history" of the Sherman Act in holding that the state is not a "person" for purposes of the statute. *Id.* at 351-52. The Court noted that "[t]he Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state." *Id.* at 351. The Court concluded that "the Sherman Act . . . must be taken to be a prohibition of individual and not state action." *Id.* at 352. That Louisiana joined with other states in settling their lawsuits against the major tobacco companies does not affect the Court's holding that the state is not a "person" within the scope of the antitrust laws, nor does it mean that the actions of Louisiana's executive, legislative, and judicial branches in entering into and approving the MSA were not actions of the state.

II. Whether the Fifth Circuit correctly applied this Court's settled rule for assessing whether an interstate agreement violates the Compact Clause does not merit this Court's review.

Nine years ago, this Court denied a certiorari petition which sought review of a Fourth Circuit decision holding that the MSA did not violate the Compact Clause. *Star Scientific, Inc. v. Kilgore*, 537 U.S. 818 (2002). As Petitioners note, the Fifth Circuit merely "adopted" the Fourth Circuit's reasoning, and nothing has happened since 2002

that warrants a different course now. This Court has not issued any intervening decision that bears on the issue and no circuit split has arisen – all six courts to have addressed whether the MSA requires congressional approval have held it does not.[9] The absence of any conflict among the courts is unsurprising given the clarity of the governing test, under which congressional approval is required only of those agreements among states that "enhance[] state power *quoad* the National Government." *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 (1978) ("*MTC*"). Petitioners' contention that the Fifth Circuit misapplied that settled law does not merit this Court's review. Certiorari is also unwarranted for another reason: As the district court held, even if the MSA needed congressional consent, Congress provided it. Pet. App. B14-15. Any ruling by this Court on whether the MSA requires congressional approval would thus be purely academic.

1. More than a hundred years ago, this Court recognized that the Compact Clause could not reasonably be read to apply to *every* agreement among multiple states. In *Virginia v. Tennessee*, 148 U.S. 503, 518, 519 (1893), the Court observed that many interstate agreements "can in no respect concern the United States" and concluded that the Compact Clause applies only "to the formation of any

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[9] *See Star Scientific*, 278 F.3d at 360; *Mariana v. Fisher*, 226 F. Supp. 2d 575, 586-87 (M.D. Pa. 2002); *PTI, Inc. v. Philip Morris Inc.*, 100 F. Supp. 2d 1179, 1197-98 (C.D. Cal. 2000); *Hise*, 46 F. Supp. 2d at 1210 (allegation of "unlawful confederation"); Pet. App. B9-15.

combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." In *MTC*, the Court reiterated that rule, 434 U.S. at 460, and upheld the Multistate Tax Compact, which resulted in reciprocal legislation by more than 20 states and the establishment of a quasi-independent administrative body to coordinate state taxation of certain entities.

The Court found that, although the agreement may have "increase[d] the bargaining power of the member States *quoad* the corporations subject to their respective taxing jurisdictions," it did not "enhance[] state power *quoad* the National Government." *Id.* at 473. The Court recognized that "[g]roup action in itself may be more influential than independent actions by the States," but observed that each of the tax commission's actions could have been taken separately by the individual states themselves. *Id.* Finally, the Court clarified that an interstate agreement does not require congressional approval merely because it "implicates some federal interest"; only agreements that pose "a threat of encroachment or interference through enhanced state power" do so. *Id.* at 479-80 n.33. *See also Northeast Bancorp, Inc. v. Bd. of Governors of Federal Reserve Sys.*, 472 U.S. 159, 175-76 (1985) (reaffirming *MTC*).

2. The MSA does not require Congress's consent under this settled jurisprudence. As the Fifth Circuit explained,

> the [MSA] may result in an increase in bargaining power of the States *vis-à-vis* the

> tobacco manufacturers, but this increase in power does not interfere with federal supremacy because the [MSA] "does not purport to authorize the member States to exercise any powers they could not exercise in its absence."

Pet. App. A6-7 (quoting *Star Scientific*, 278 F.3d at 360 (quoting *MTC*, 434 U.S. at 473)).

Indeed, as Judge Niemeyer observed for the Fourth Circuit, the MSA "principally operates vertically between each State and the signatory tobacco companies, providing releases from liability to the tobacco companies in exchange for conduct restrictions and payments." *Star Scientific*, 278 F.3d at 360. Such "vertical" agreements between individual states and tobacco companies do not even implicate the Compact Clause. *Id.*

The MSA operates "horizontally" between the States only in providing that third parties will perform certain useful but limited administrative functions. In particular, the MSA requires the parties to select a "Firm" of economic consultants to make certain determinations that are conditions precedent to one of the potential payment adjustments in the MSA, the NPM Adjustment. For example, were there to be a dispute between the PMs and a state as to whether the state's Escrow Statute is a "Qualifying Statute" as defined in Section IX(d)(2)(E), the firm would decide it. *See* MSA §IX(d)(2)(G). In addition, the MSA requires the parties to select an "Independent Auditor" (*i.e.*, an accounting firm) to calculate the exact payments due each year under the MSA from each PM, and their

allocation among the Settling States, according to formulas specified in the MSA. *See id.* §XI. Lastly, the MSA assigns to the National Association of Attorneys General ("NAAG") certain implementing and coordinating functions on behalf of the Settling States, including the monitoring of potential conflicting interpretations of the MSA by courts in the various Settling States. *See id.* §§II(bb); VII(f), (g); VIII(a), (c). It is difficult even to conceive how states' agreement to use the same economic and accounting experts and their Attorneys General's membership organization to help administer a complex payment mechanism and help ensure consistency in the interpretation of the MSA could be considered to encroach on federal supremacy.

Petitioners' complaint that the MSA binds the states into the future is both misplaced and wildly overblown. *See* Pet. Br. 26, 28; *see also* Amicus Brief of Constitutional Law Scholars ("Amicus Br.") 14-16. The states have agreed to receive significant Annual Payments from PMs in perpetuity in exchange for waiving certain specified claims they had or might in the future have against the PMs. The states have also agreed to have the Firm, the Independent Auditor, and NAAG continue to perform certain implementing and coordinating functions, described above, into the future. The states could have individually settled their lawsuits against the PMs with the same or fully equivalent terms. There is nothing "particularly pernicious" (Amicus Br. 14) about those settlement terms, and nothing about them that remotely encroaches on federal supremacy.

Moreover, as the Fourth Circuit further observed, the MSA took care to ensure that it "does not derogate from the power of the federal government to regulate tobacco. Sections X and XVIII(a) of the agreement specifically anticipate that Congress may, in the future, pass laws regulating tobacco and provides [sic] for adjustments of the [MSA's] terms if that occurs." *Star Scientific*, 278 F.3d at 360.[10] Accordingly, although the MSA undoubtedly touches upon matters of federal "interest," it does not "infringe federal supremacy." *Northeast Bancorp*, 472 U.S. at 176.[11]

3. Petitioners contend that the Fifth Circuit erred in holding that the MSA does not require congressional approval. This Court does not, of course, grant certiorari merely to correct errors by lower courts, and Petitioners' evident dislike for the MSA is hardly reason to make an exception. Petitioners' criticisms of the Fifth Circuit are, in any event, unfounded.

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[10] Section X addresses the consequences of federal tobacco-related legislation enacted on or before November 30, 2002. Section XVIII(a) provides that "[i]f any current or future law includes obligations or prohibitions applying to Tobacco Product Manufacturers related to any of the provisions of the Agreement, each Participating Manufacturer shall comply with this Agreement unless compliance with this Agreement would violate such law."

[11] Petitioners note several purported factual differences between the MSA and the Multistate Tax Compact at issue in *MTC*, Pet. 26-27, but none of those differences bears on the application of the guiding rules set forth in *MTC*.

Petitioners' principal contention appears to be that the Fifth Circuit somehow failed to heed the Court's statement in *MTC* that "the pertinent inquiry is one of potential, rather than actual, impact upon federal supremacy." 434 U.S. at 472, *quoted in* Pet. 27. But Petitioners' "potential encroachment" theory is little more than an effort to repackage failed statutory and constitutional arguments in the guise of a Compact Clause claim. In the end, they fail to show how the MSA even potentially encroaches on federal power.

For example, the Fifth Circuit rejected Petitioners' claim that the Federal Cigarette Labeling and Advertising Act ("FCLAA"), 15 U.S.C. §1334, preempts the MSA because the Agreement's voluntary advertising, promotional, and marketing restrictions do not fall within the scope of the statute's preemption provision, which applies only to any "requirement or prohibition . . . imposed under State law." Pet. App. A13-14. Petitioners nonetheless argue that the MSA's voluntary advertising restrictions have the "potential" to encroach on federal supremacy. Pet. 31-32. But those voluntary advertising restrictions are not now, and never will be, a "requirement or prohibition" that Congress sought to oust. Although those restrictions may touch upon a matter of federal "interest," it is impossible to see how states engaging in conduct Congress chose *not* to preempt "enhances state power *quoad* the National Government." And that is so whether the states engage in that conduct through 46 separate agreements or one master agreement signed by multiple states. *See MTC*, 434 U.S. at 472 ("[t]he number of parties to an

agreement is irrelevant if it does not impermissibly enhance state power at the expense of federal supremacy.").

At bottom, Petitioners' argument appears to be premised on the fact that the MSA touches on a variety of matters that are of federal interest. But, as explained above, this Court in *MTC* expressly held that "[a]bsent a threat of encroachment or interference through enhanced state power, the existence of a federal interest is irrelevant." 434 U.S. at 480 n.33. In sum, the Fifth Circuit's ruling, like the Fourth Circuit's before it, is firmly grounded in this Court's precedents.

Lastly, Petitioners assert that the Fifth Circuit erred because the MSA potentially encroaches upon "sister-state interests." Pet. 33. This error-correction argument also fails on its own terms. First, it is far from clear that Petitioners even have standing to assert state sovereignty interests. *See Tennessee Elec. Power Co. v. TVA*, 306 U.S. 118, 144 (1939). Second, no state has objected to the MSA, and if such an objection were made, the Court in *MTC* expressly dealt with how it should be resolved:

> Any time a State adopts a fiscal or administrative policy that affects the programs of a sister State, pressure to modify those programs may result. Unless that pressure transgresses the bounds of the Commerce Clause or the Privileges and Immunities Clause of Art. IV, 2, it is not clear how our federal structure is implicated.

434 U.S. at 478 (citation omitted). The MSA does not "transgress[] the bounds of the Commerce Clause," the First Amendment, the FCLAA, or the Sherman Act. The "federal structure is" therefore not "implicated," and the Compact Clause did not require congressional consent.

4. Certiorari is not warranted on the question whether congressional approval of the MSA was required by the Compact Clause for an independent reason: Even if congressional consent to the MSA were required, Congress provided it in 1999 when it amended the Medicaid Act to disclaim any federal interest in the moneys received by the states under the MSA in settlement of their claims, *inter alia*, for Medicaid payments made by the states. This Court has long held that "Congress may consent to an interstate compact by authorizing joint state action in advance or by giving expressed or implied approval to an agreement the States have already joined." *Cuyler v. Adams*, 449 U.S. 433, 441 (1981); *see also Virginia v. Tennessee*, 148 U.S. at 521-22. Moreover, "the constitution makes no provision respecting the mode or form in which the consent of congress is to be signified." *Green v. Biddle*, 21 U.S. 1, 85-86 (1823). "The only question in cases which involve that point is, has congress, by some positive act, in relation to such agreement, signified the consent of that body to its validity?" *Id.* at 86. Here, as the district court correctly held (Pet. App. B14-15), the answer is yes.

When Congress amended the Medicaid statute in 1999, it expressly disclaimed any claim for reimbursement of the federal share of Medicaid

payments from MSA settlement payments, stating that the relevant federal rules

> shall not apply to any amount recovered or paid to a state as part of *the comprehensive settlement of November 1998* between manufacturers of tobacco products . . . and State Attorneys General, ... *[A] State may use amounts recovered or paid to the State as part of a comprehensive . . . settlement, . . . for any expenditures determined appropriate by the State.*

42 U.S.C. §1396b(d)(3)(B)(i-ii) (Supp. V 1999) (emphases added). Through this provision, Congress recognized the MSA's existence, disclaimed any federal interest in the moneys received by Louisiana and other states under the agreement, and authorized the states to use MSA funds "for any expenditures determined appropriate." The inference is "clear and satisfactory" that Congress "necessarily consented to the agreement of th[e] States on th[e] subject." *Virginia v. W. Virginia*, 78 U.S. 39, 60 (1870). Were there any doubt that Congress by this enactment approved the States' decisions to enter the MSA, the Conference Report accompanying the Medicaid Act amendment dispels it. The Report expressly stated that Congress's purpose in disclaiming its interest was to avoid needless litigation by providing certainty and finality to the states in their use of the MSA funds.[12]

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[12] *See* House Conf. Rep. 106-143, 106th Cong. 1st Sess., Pub. L. No. 106-31, Emergency Supplemental Appropriations, May 14, 1999, 1999 U.S.C.C.A.N. 27.

Petitioners argued below that, notwithstanding the Medicaid amendment's explicit reference to the MSA and the states' use of MSA funds, Congress did not properly "consider[] the substance of the MSA or the Compact Clause implications of its actions" because the 1999 Medicaid amendment was "obscure." C.A. Br. 56. Congress is presumed, however, to be fully aware of its enactments. *See Railroad Retirement Bd. v. Fritz*, 449 U.S. 166, 179 (1980). Nor does it matter that Congress acted through an appropriations bill. As noted, the Constitution requires no particular form by which Congress must approve a compact, and Congress "may amend substantive law in an appropriations statute, as long as it does so clearly." *Robertson v. Seattle Audubon Soc.*, 503 U.S. 429, 440 (1992). Petitioners cannot credibly dispute that Congress amended the Medicaid statute with a specific reference to the MSA, and that the amendment effected a change in law.

The Fifth Circuit did not reach the issue of congressional consent because it concluded – like every other court to address the issue – that no such consent was required. The fact of Congress's consent, however, makes the question presented by Petitioners entirely academic. Even if they were correct that congressional consent were required – and they are not – it would not change the outcome of this case and the continuing validity of the MSA.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

JAMES D. "BUDDY" CALDWELL
Louisiana Attorney General
JAMES TREY PHILLIPS
First Assistant Attorney General
S. KYLE DUNCAN*
Appellate Chief
LOUISIANA DEPARTMENT OF JUSTICE
P.O. Box 94005
Baton Rouge, LA 70804-9005
(225) 326-6716 (tel.)
DuncanK@ag.state.la.us

Counsel for Respondent

*Counsel of record

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No. 10-622

In The
Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE # 1, and MARK HEACOCK,
Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,
Respondent.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Fifth Circuit

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, NW
Washington, DC 20008
(202) 237-8165
jaffe@esjpc.com

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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REASONS FOR GRANTING THE WRIT

Despite respondent's protests, the MSA is a horizontal collective agreement among competing tobacco companies and among sister States that, by its express terms, restrains trade, invades state sovereignty, and encroaches upon federal authority. Respondent's and the Fifth Circuit's approach in rejecting the antitrust and Compact Clause challenges in this case effectively eliminate *Parker*'s limits on antitrust immunity and render the Compact Clause a redundant nullity.

This case is an appropriate and well-framed vehicle for addressing those issues. It correctly frames the antitrust issue in terms of the *MSA*'s legality as a contract in restraint of trade rather than as a challenge to the Escrow Statute alone. And it allows this Court to consider the essential interplay between the antitrust and Compact Clause issues, which both involve fundamental federalism concerns.

That the Fifth Circuit rejected petitioners' *Parker*-based antitrust challenge by relying on irrelevant cases addressing whether the Escrow Statute and the MSA mandated further or subsequent anticompetitive conduct is not a vehicle problem. Rather, it is an inadequacy in the court's reasoning that enhances, rather than diminishes, the justification for certiorari. Likewise, the Fifth Circuit's bare repetition of the flawed Compact Clause analysis in *Star Scientific* shows that such reasoning has become entrenched and is unlikely to benefit from further percolation. Given the tremendous economic, political, and constitutional importance of these issues, it is now time for

this Court to weigh in regardless whether there is a circuit split.

I. Agreements Among Multiple States and Private Companies in Restraint of Nationwide Commerce Are Not Immune from the Antitrust Laws.

Unlike the challenges in most other MSA cases, which focused on the effects of the Escrow Statutes on subsequent competitive behavior and did not directly challenge the MSA itself, the gravamen of the antitrust claim here is that the MSA itself and by its terms is a "contract * * * in restraint of trade" that is not immunized by the fact that States are parties to that contract. *Parker* v. *Brown*, 317 U.S. 341, 350-52 (1943). That is how the claim was presented to the Fifth Circuit, and state-action immunity was respondent's virtually exclusive defense. *See* Opening Brief of Appellants at 35-40 (discussing *Parker*); Reply Brief of Appellants at 15-18 (same); Brief of Appellee at 26-30 (citing *Parker* and its progeny to argue that the MSA and its implementing statutes are entitled to state-action immunity).[1]

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[1] Notwithstanding respondent's assertion, at 20, the antitrust claim was more than adequately pled and litigated below. Complaint ¶¶ 7, 34-35, 61-62 [R24, R32, R42]; Plaintiffs' Opp. to Motion to Dismiss 16-21 [R335-40]; Plaintiffs' Mem. in Support of Sum. Judgment 23-27 [R2094-98]; Plaintiffs Opp. to Motion for Sum. Judgment 17-22 [R1518-23]. The Fifth Circuit declined to endorse respondent's contrary argument on appeal, and proceeded to rule, albeit erroneously, on the merits of the claim. The antitrust claim thus is properly before this Court, both as a stand-alone issue and as a component of the Compact Clause analysis.

The Fifth Circuit acknowledged the nature of that challenge but rejected it with the non-sequitur that the Escrow Statute, either alone or in combination with the MSA, did not mandate any *subsequent* conduct in violation of the antitrust laws "in all cases." Pet. App. A8-A9 (citation and internal quotation marks omitted). But the court of appeals never disputed that the MSA itself would be an illegal contract if entered into solely among private parties. And the court offered no response to *Parker*'s proviso that States may not join as "participant[s] in a private agreement or combination by others for restraint of trade" and thereby immunize it. *Parker*, 317 U.S. at 351-52.

Respondent seeks to turn this deficiency into a virtue by arguing, at 19-22, that the court never reached the *Parker* question but ruled only that there was no preemption in the absence of further compelled violations in all cases. Like the Fifth Circuit, however, respondent misconceives the *Parker* issue presented in this case. Petitioners' challenge to the MSA itself is unlike facial challenges to state statutes that are not themselves contracts or combinations subject to the Sherman Act. Such challenges must first demonstrate that the statutes mandate third parties to engage in subsequent *per se* violations "in all cases." *Rice* v. *Norman Williams Co.*, 458 U.S. 654, 661 (1982). But where the state action and the illegal contract are one and the same, the two-part immunity analysis for statutes that are separate from the alleged violations collapses into the single question whether direct state involvement in an otherwise il-

legal contract among private parties thereby immunizes that contract.

The Fifth Circuit's misplaced discussion of whether the tobacco companies are compelled to engage in subsequent antitrust violations thus did not resolve any questions "antecedent" to the *Parker* issue in *this* case; only questions from other MSA cases that were neither relevant nor responsive to the different aspect of *Parker* that was before it.[2] Notwithstanding that analytic failure the Fifth Circuit upheld the MSA as valid state action, and thus necessarily ruled on and rejected petitioners' *Parker*-based challenge. The issue of state-action immunity is properly before this Court.

On the central question whether the participation of the States in the MSA immunizes it from the Sherman Act, respondent, at 24-25, argues (1) that *Parker* allowed immunity even in the face of interstate effects, and (2) that States are not "person[s]" to whom the Sherman Act applies.

Parker, however, involved the regulation by California of raisin growers in California. That regulation may have had interstate *effects*, but it did not involve regulation across state lines, let alone a massive agreement among States and private industry to restrain trade in all fifty States. Nothing in *Parker*'s

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[2] That the Sixth Circuit in *Tritent International Corp.* v. *Kentucky*, 467 F.3d 547, 557-58 (CA6 2006), viewed its state-action analysis as distinct "preemption" and *Parker*-immunity issues is irrelevant to this case. Such a distinction is more of nomenclature than substance – *Parker* itself was effectively a preemption case – and where the illegal contract and alleged state action are the same, any such distinction collapses and is meaningless.

language or federalism-based rationale supports extending immunity to such an agreement. Pet. 17-22. And the relevant portion of the Sherman Act at issue here does not purport to apply to "persons" at all, but rather declares that "[e]very contract * * * in restraint of trade" is "illegal," without limitation on the identities contracting parties. 15 U.S.C. § 1.[3]

In its factual discussion, respondent also raises irrelevant factual disputes regarding the competitive effects of the MSA. BIO 9-13, The antitrust claim in this case, however, does not depend on the eventual *effects* of the MSA, but rather on the direct terms of that agreement, which expressly require price stabilization by imposing offsetting costs on competing NPMs, expressly divide markets by imposing fees on grandfathered SPMs that exceed their allotted market share, restrict competitive advertising, and tie payment obligations to future market share. Pet. 4-7. Every one of those actions, if contained in an agreement solely among private parties, would constitute a *per se* violation of the Sherman Act, wholly apart from whether they were actually successful in suppressing competition. Pet. 16-17; *see National Electrical Contractors Ass'n* v. *National Constructors Ass'n*, 678 F.2d 492, 497 (CA4 1982) (agreement imposing offsetting costs on competitors is a *per se* illegal attempt to "stabilize prices").

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[3] Other references to "persons" in the penalty clauses of the Sherman Act, 15 U.S.C. § 1, are irrelevant given that petitioners are not seeking such penalties; merely a declaration and an injunction.

Even were the ultimate competitive effects of the MSA relevant to the question presented, respondent is still mistaken in disputing such effects now. There is ample evidence in the record that the MSA has enabled the Majors to charge supra-competitive profits and suppressed competition from NPMs. *See* Pet. 7 nn. 2 & 3 (MSA allowed OPMs to raise prices by far more than necessary to pass through MSA costs; OPM profits increased dramatically); *Report of Plaintiffs' Expert Jeremy Bulow* at 33-34 (Aug. 13, 2008) (NPM market share in Louisiana declined by 92 percent to 0.12 percent of the market immediately following amendment to Escrow Statute); *Amicus* Brief of Freedom Holdings, at 6-7 (following amendment to Escrow Statutes, NPM market share in MSA States declined well below NPM market share in non-MSA states). Because this case was decided by summary judgment on purely legal grounds without addressing any factual disputes regarding the effects of the MSA, such disputes must be viewed in favor of the non-moving party.[4]

II. The Decision Below Strips the Compact Clause of All Independent Meaning.

On the Compact Clause question, respondent largely ignores the arguments in the Petition, and simply endorses the rationale of the Fourth Circuit in *Star Scientific* and the Fifth Circuit below. BIO 27-

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[4] In any event, evaluating the economic and policy effects of the MSA is more appropriately done by Congress. The existence of disputes over such effects is a further reason for applying the Compact Clause to the MSA and requiring that it be presented to Congress for approval.

28. Respondent does not deny that its reading of the Compact Clause would render that clause redundant with the Supremacy Clause. Indeed, according to respondent, it seems, if there is no *actual* violation of some other statutory or constitutional provision there can be no potential encroachment under the Compact Clause. BIO 33.[5] Respondent does not attempt to reconcile its construction with basic principles of constitutional interpretation. *Marbury* v. *Madison*, 5 U.S. 137, 174 (1803) ("It cannot be presumed that any clause in the constitution is intended to be without effect").

Respondent's approach is also inconsistent with this Court's cases addressing the function and purpose of the Compact Clause and its role in protecting the federal system and the prerogatives of both the federal government and the States. Pet. 22-26.

In seeking to expunge this Court's emphasis in *MTC* on evaluating state agreements for their "potential" encroachment of federal authority, respondent argues, at 32, that the mere existence of a "federal interest" in the subject matter of a compact is insufficient to trigger the Compact Clause. Respondent fails, however, to address the far more persuasive interpretation of *MTC* by the Office of Legal Counsel, which sets out factors establishing when a compact goes beyond merely touching federal interests and

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[5] Although respondent takes issue with petitioners' earlier FCLAA preemption claim, not now before this Court, BIO 31, it effectively ignores the MSA's extraterritorial imposition of fees and restrictions on speech and petitioning, which, at a minimum, encroach upon state sovereignty and federal commerce authority. Pet. 7-10, 33-34.

rises to the level of potential encroachment. *See* Applicability of Compact Clause to Use of Multiple State Entities Under the Water Resources Planning Act, 4B Op. Off. Legal Counsel 828, 830-31 (1980); *see also* Amicus Brief of Constitutional Law Scholars, at 10-11 (discussing OLC standards and how MSA meets every one). Here, the MSA's anticompetitive and extraterritorial provisions, and its restrictions upon the member States themselves, more than satisfy the criteria the OLC describes as triggering the States' submission obligation and Congress's consent authority under the Compact Clause.

Respondent's suggestion, at 28, that the MSA is not an agreement among the States because it operates vertically between States and companies, rather than horizontally, simply ignores the plain terms of the agreement. The States have agreed among themselves: to pool and divide revenues from the MSA; to diligently enforce their escrow statutes in order to reduce competition from NPMs; and to incur severe financial penalties should any State fail to meet those obligations. Pet. 7-9. They have likewise collectively granted the Firm unreviewable enforcement authority over States that fail to diligently enforce their escrow statutes bound future state officials, and restricted those officials' MSA-related speech and lobbying. *Id.* None of that could be adopted and enforced by States acting individually without the collective obligations and penalties under the MSA.

Finally, respondent, at 33-35, claims that the MSA was approved by Congress as a compact, and hence satisfies the Compact Clause. Although the district

court accepted that argument, it was not adopted by the court of appeals.

The passing reference in the Medicaid Amendment does not remotely qualify as consent to an interstate compact. The Medicaid Amendment had as its sole purpose eliminating the uncertainty over whether the States had to remit to the federal government a portion of the funds collected under several different tobacco settlements as compensation for Medicaid expenditures. The amendment declared only that Medicaid's claw-back rules "shall not apply" to moneys from the MSA and other tobacco settlements. 42 U.S.C. § 1396b(d)(3)(B)(i)-(ii).[6] It made no broader pronouncements regarding the MSA or any of the other potential legal issues surrounding that agreement, and certainly did not purport to ratify it in total, either as a compact or otherwise.[7]

Implied approval of compacts should be "necessar[y]" and "clear and satisfactory." *Virginia v. West Virginia*, 78 U.S. 39, 60 (1871). That the implied approval asserted by respondent came in an appropria-

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[6] Defendant's reliance, at 48-49, on the Conference Report discussing the amendment is misplaced. The only litigation uncertainty the conferees sought to avoid was that "absent Congressional action, the issue of the Federal share of funds recovered under such settlements or judgments would be subject to litigation over the next several years." H.R. CONF. REP. 106-143, 1999 WL 303282, *55 (May 14, 1999).

[7] In fact, respondent implicitly conceded the point at oral argument below. Oral Arg. Recording, No. 09-30985, July 7, 2010, at 30:42 to 31:34 (Respondent's counsel conceding that Medicaid Amendment's reference to MSA did not approve of every aspect of the MSA or supersede other federal statutes) (available at www.ca5.uscourts.gov/OralArgumentRecordings.aspx).

tions bill further demonstrates that it is neither and did not ratify the MSA as a whole. In *TVA* v. *Hill*, 437 U.S. 153, 189-92 (1978), for example, the Court resoundingly rejected implied ratification from appropriations provisions, notwithstanding that the Committee Reports there expressly referred to the potential illegal agency conduct that was supposedly ratified. The Medicaid Amendment, by contrast, makes no mention of the Compact Clause or other legal challenges to the MSA. *See also In re Endo*, 323 U.S. 283, 303 n.24 (1944) (Congressional funding of detentions did not constitute "Congressional ratification"; "appropriation must plainly show a purpose to bestow the precise authority which is claimed"); *Greene v. McElroy*, 360 U.S. 474, 506-07 (1959) (Congressional funding of Defense Department security procedures did not constitute "implied ratification").

As this Court has observed, Congress does not "hide elephants in mouse holes," *Whitman* v. *American Trucking Ass'n*, 531 U.S. 457, 468 (2001).

III. This Petition Presents Important Issues Having a Tremendous Impact on the National Economy and Our Federal System.

Offering little to rebut the tremendous economic, political, and constitutional consequences of MSA and the reasoning of the decision below, respondent instead emphasizes the absence of a split and previous denials of certiorari to discourage certiorari here. But given the national importance of the MSA and the antitrust and Compact Clause questions presented, certiorari is warranted even absent a split. Indeed, the particularly thin analysis of the decision

below demonstrates that the lower courts' approach to MSA challenges is becoming entrenched, further time is unlikely to add to the analysis of the issues, and it is time for this Court to consider the issues itself.[8] The many billions of dollars at stake, the unwarranted extension of state action immunity, and the effective elimination of the Compact Clause from the Constitution are all sufficiently important for this Court to have the final say on full briefing, and not leave such matters to the lower courts.

As for respondent's further suggestion, at 24, that the issues presented by the MSA are unlikely to arise in other contexts, that is incorrect. The grave danger is that the MSA will be the model for future agreements between States and private industry, in which state attorneys general secure revenues, the industries receive protection from competition, and consumers and taxpayers suffer the consequences. *See* Seth M. Wood, *The Master Settlement Agreement as*

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[8] That the Fifth Circuit merely quoted the Fourth Circuit's erroneous Compact Clause reasoning without addressing petitioners' arguments concerning the flaws in that reasoning is not a reason to deny certiorari. BIO 25-26. Rather, it shows the lack of considered attention the issue is receiving in the lower courts. This Court's previous denial of certiorari in *Star Scientific Inc.* v. *Beales*, 278 F.3d 339, 359 (CA4), *cert. denied*, 537 U.S. 818 (2002), likewise does not call for the same result here. *Star Scientific* was the first case to address the Compact Clause issue, there have been nearly ten unproductive years of percolation since, and the consequences of the MSA have gotten progressively worse in the wake of the 2003 amendment to the Escrow Statutes, which virtually purged NPMs from the market in MSA States. *Supra* at 6. Such changed legal and factual circumstances call for a grant of certiorari now, notwithstanding this Court's willingness to let the issue lie in 2002.

Class Action: An Evaluative Framework for Settlements of Publicly Initiated Litigation, 89 VA. L. REV. 597, 600-01 (2003) (noting current and likely future use of the MSA model against other industries).

Even if the MSA itself were unlikely to be replicated, however, it is damaging enough in its own right, extracts billions of dollars annually from consumers, and will continue in perpetuity. Moreover, the expansion of *Parker* immunity and the effective elimination of the Compact Clause have application beyond agreements modeled on the MSA, and open the door for tremendous state mischief involving the environment, energy, and other areas previously dealt with via federally approved compacts. *See* Pet. 25. This case and the issues herein are thus of exceptional national importance and should be reviewed and resolved by this Court.

CONCLUSION

For the reasons above, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

ERIK S. JAFFE
(Counsel of Record)
ERIK S. JAFFE, P.C.
5101 34th Street, N.W.
Washington, D.C. 20008
(202) 237-8165

MICHAEL MCCONNELL
559 Nathan Abbott Way
Stanford, CA 94305

HANS F. BADER
SAM KAZMAN
COMPETITIVE ENTERPRISE
INSTITUTE
1899 L Street, NW
Washington, D.C. 20036

Counsel for Petitioners

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Supreme Court, U.S.
DEC 10 2010
OFFICE OF THE CLERK

No. 10-622

In The
Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE # 1, and MARK HEACOCK,
Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR ANTITRUST LAW PROFESSORS AS AMICI CURIAE IN SUPPORT OF PETITIONER

TODD J. ZYWICKI
3301 Fairfax Dr.
Arlington, VA 22201

JOSHUA D. WRIGHT
3301 Fairfax Dr.
Arlington, VA 22201

C. BOYDEN GRAY
(Counsel of Record)
GRAY & SCHMITZ, LLC
1627 I St NW
Suite 950
Washington, DC 20006
(202) 955-0620
cbg@cboydengray.com
Counsel for Amicus Curiae

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INTEREST OF AMICI CURIAE[1]

The amici curiae submitting this brief are distinguished professors of law who teach, conduct research, and publish in the area of antitrust and competition law and economics.

Keith N. Hylton is Honorable Paul J. Liacos Professor of Law at Boston University School of Law.

Thomas A. Lambert is Associate Professor at University of Missouri School of Law.

Fred S. McChesney is Class of 1967 / James B. Haddad Professor at Northwestern University School of Law.

Joshua D. Wright is Associate Professor at George Mason University School of Law and Department of Economics.

Todd J. Zywicki is George Mason University Foundation Professor of Law at George Mason University School of Law.

Amici have no financial interest in any party to the case or in the outcome of the case. Neither party, nor any of either party's counsel, authored this brief in whole or in part.

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[1] This brief is filed pursuant to the written blanket consents on file with this Court. Per the terms of such consents, written notice was provided to the parties more than ten days prior to the filing of this brief. No counsel for a party authored this brief in whole or in part, nor did any person or entity, other than Amici or its counsel, make a monetary contribution intended to fund the preparation or submission of this brief. The International Center for Law and Economics ("ICLE") provided funding to the brief's principal authors, Professors Todd Zywicki and Joshua Wright, for preparation and filing of the brief.

STATEMENT

Petitioners seek a writ of certiorari to review a decision affirming a grant of summary judgment that the tobacco Master Settlement Agreement is beyond antitrust scrutiny under the state action doctrine. Petitioners are a small tobacco company, a consumer, and a tobacco shop. The plaintiffs contend that the agreement violates the antitrust laws and, because it was not approved by Congress, the Compact Clause of Article I, § 10. The court of appeals held that the agreement is immune from antitrust scrutiny as state action under Parker v. Brown, 317 U.S. 341 (1943).

This brief focuses on the question of whether state action immunity applies to a cartel-facilitating arrangement with significant interstate effects. Disagreements across the Circuit Courts of Appeals call into question the extent of the state action doctrine immunizing private actors within state-facilitated cartels. The Fifth Circuit decision purports to expand the scope of the state action doctrine to immunize cartel arrangements merely sanctioned by, as opposed to actively monitored by, the state. The widespread and entrenched nature of the national tobacco cartel arising from the challenged restraint necessitates this Court's intervention.

SUMMARY OF ARGUMENT

1. This case involves an antitrust challenge to the 1998 Master Settlement Agreement ("MSA") between

the four largest tobacco manufacturers ("Majors")[2] and the Attorneys General of 46 states. The MSA is designed to create – and actually creates – a national cigarette cartel to maintain the market shares of participating manufacturers ("PMs"), to suppress competition from non-participating manufacturers ("NPMs"), and to increase tobacco prices. This cartel extracts monopoly profits for the Majors and tax revenues for the states at the cost of massive consumer welfare losses through decreased quantities supplied, increased prices, and stifled innovation.

2. The MSA establishes a nationwide cartel through a dual system of incentives for PMs and penalties for NPMs. The MSA systematically insulates PMs from competitive disadvantages vis-à-vis NPMs by simultaneously fixing PM liabilities as a function of market shares, subsidizing PMs that lose market share as a result of the MSA, and requiring comparable "escrow payments" from NPMs that refuse to join the MSA. The MSA threatened to withhold settlement funding from states that did not pass statutes mandating escrow payments from NPMs. The states responded, as anticipated, with escrow statutes designed to prevent inter-state competition for tobacco regulation and thereby inhibit NPMs from gaining national market share as a result of price increases from the MSA. Cigarette prices between 1998 and 2002 increased by double the additional costs of the MSA.

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[2] The four Majors are Phillip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company and Lorillard Tobacco Company.

3. Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, prohibits a "contract, combination . . . or conspiracy, in restraint of trade or commerce." Furthermore, contracts among competitors at the same market level – "horizontal" contracts – to divide markets, raise prices, or otherwise suppress competition are per se illegal. Without state prompting and endorsement, the MSA would doubtlessly present an emblematic per se violation of Section 1 of the Sherman Act, as it seeks to suppress competition through limiting advertisements and dividing market shares. As Judge Ralph Winter noted about the MSA, "Had the executives of the major tobacco companies entered into such an arrangement without the involvement of the States and their attorneys general, those executives would long ago have had depressing conversations with their attorneys about the United States Sentencing Guidelines." Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 225 (2d Cir. 2004) (Freedom Holdings I). Yet several judicially-crafted limitations on the Sherman Act, each predicated on state intervention, sometimes immunize or lessen antitrust scrutiny of otherwise per se illegal restraints.

4. This Court has held that the antitrust laws do not apply to states acting in their sovereign capacity. Parker v. Brown, 317 U.S. 341, 350-51 (1943). When a state program is "clearly articulated and expressed as state policy [and] the [State] policy is 'actively supervised' by the State itself," Parker 'state action' immunity exempts normally illegal conduct from the Sherman Act's prohibition. California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980). A state cannot claim Parker immunity

through intermittent or "gauzy" involvement in "a[n] essentially private price-fixing arrangement." Id. at 106. If a state program merely provides a "hybrid restraint" which "contemplates a private market decision but provides a nonmarket mechanism for enforcing [that] decision," then the validity of the state restriction largely depends on the level of actual state involvement. Rice v. Norman Williams Co., 458 U.S. 654, 665-66 (1982) (Stevens, J., concurring). When compliance with a state restriction necessitates "a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute," federal antitrust laws preempt the state restriction. Id. at 658 n.4, 661.

5. The Midcal and Rice limitations on state action immunity reflect this Court's skeptical view of anticompetitive state regulation Scholars of the regulatory process and antitrust enforcement officials have recognized that regulated businesses – deprived of more straightforward, private anticompetitive combinations – will attempt to substitute into public-private partnerships in order to legitimize conduct that violates the antitrust laws. Midcal accordingly requires both clear articulation and active supervision of state action to qualify for Parker immunity. Even when the state satisfies these requirements, state action that would necessarily compel per se violation of the antitrust laws nonetheless runs afoul of Rice. Both of these restrictions recognize the potential mischief in a broad state action doctrine; minimizing special interest legislation remains part of federalist traditions since James Madison's comments

on factionalism in Federalist 51. The MSA permits states to elude the political consequences of anticompetitive laws by insulating them from the constraints imposed by the inter state competition that horizontal federalism is intended to provide. Both of these consequences militate against finding Parker immunity.

6. Conflicting Federal Circuit Court opinions reviewing the antitrust implications of the MSA also make this case unusually important and ripe for review by this Court. The Fifth Circuit has not offered a coherent explanation relevant to this case. The Fifth Circuit instead cited Sanders v. Brown, a Ninth Circuit decision also examining the competitive consequences of the MSA. In Sanders, the Ninth Circuit speculated that in light of this Court's decision in Hoover v. Ronwin, Midcal may no longer remain good law. Sanders v. Brown, 504 F.3d 903, 916 (9th Cir. 2007). The Ninth Circuit therefore held that, sans Midcal, "a state need not show that it 'actively supervises' private parties, as long as the state itself, acting as sovereign, created the restraint of trade." Id. (citing Hoover v. Ronwin, 466 U.S. 558, 568-69 (1984)). The Second and Third Circuits, however, have applied Midcal to examine state and private antitrust immunity claims resulting from the MSA. See Freedom Holdings I at 305; A.D. Bedell Wholesale Co. v. Phillip Morris, Inc., 263 F.3d 239 (3d Cir. 2002). Tension between the circuits as to the scope of Hoover, the interplay between Midcal and Rice, and even whether Midcal remains good law underscore the deep confusion that exists today regarding the interaction of these three doctrines and the pressing need

for this Court's guidance. This need for clarification is especially important where, as here, courts scrutinize what amounts to an integrated national settlement of commerce with an unquestionable interstate nature.

7. The MSA presents the largest settlement in American history – nearly a quarter-trillion dollars – and impacts both taxpayers and consumers in every state, directly and indirectly. The MSA is antithetical to the principles of federalism upon which the state action exception to the antitrust laws is grounded. This Court's guidance is both necessary due to the impending and growing split amongst the Circuit Courts of Appeals as to the extent of Parker immunity as well as the billions of dollars at stake in the result.

ARGUMENT

I. The MSA and Escrow Statutes Form a National Cartel in the Cigarette Market.

On November 23, 1998, the Attorneys General of 46 states signed an agreement settling allegations that the largest four tobacco manufacturers defrauded the states of Medicaid expenses.[3] The Master Settlement Agreement obligates the Majors and other manufacturers who opt in to the MSA to make annual payments totaling $206 billion. Under the MSA's terms, PMs' payments are calculated on the basis of their current national market shares. The annual payments are then allocated to the settling

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[3] Mississippi, Florida, Texas, and Minnesota reached settlements prior to this date.

states. The MSA also prohibits PMs from various tobacco-related lobbying and advertising activity. MSA §§ III(b)-(i); III(m)-(p). The MSA raises the costs of cigarettes by approximately 35 cents per pack.

Structuring damage payments in this way would have created a significant competitive advantage for NPMs, which would have been able to undercut PMs' resulting inflated prices. The MSA contemplates this consequence by including several provisions that provide incentives for NPMs to join the settlement, thereby mitigating the competitive consequences of the PMs' annual payments to the states. These NPMs are often smaller companies which would stand to gain substantial market share by not joining the MSA. The MSA's incentives are accordingly generous.

First, new participants in the settlement which subject themselves to the tax increase within 90 days make zero MSA payments at all on sales at or below a benchmark level, defined as the higher of their 1998 sales or 125 percent of their 1997 sales. MSA § IX(i). To put the magnitude of this subsidy in perspective, a small manufacturer with sales of $100,000 per month would be entitled to a $1.5 million annual tax subsidy. See Jeremy Bulow, Director, Bureau of Econ., Fed. Trade Comm'n, The State Tobacco Settlements and Antitrust (June 25, 2007).

Second, the MSA includes provisions entitling Majors to substantial reductions in their required payments in the event that they lose market share to non-participating manufacturers. MSA §§ II(ff), IX(d). These "adjustments" insure the Majors will be

compensated for any decrease in market share resulting from the MSA.

Third, the MSA also provides significant incentives for states to join. The MSA requires each settling state to pass a model "qualifying" or "escrow" statute. These statutes require manufacturers who refuse to join the MSA to make alternative "trust fund" payments as a so-called "bond" against future claims. States that did not pass model statutes forfeit their share of tax revenue, while consumers in states that did not pass model statutes still bear the burden of the national tax. With these incentives, it is no surprise that smaller manufacturers joined and states enforced the MSA.

Consider the competitive consequences of the MSA. The MSA imposed significant costs of NPMs in order to prevent them from acquiring a "resulting cost advantage." Escrow statutes such as the one challenged here require NPMs to put significant payments in escrow equivalent to a full payment under the MSA. The MSA also exposes NPMs and their customers to the possibility of being sued by the states. Further, escrow statutes also impose other burdensome compliance costs on non-participating manufacturers. See, e.g., LA. REV. STAT. §§ 13:5071-77, 47:843D.

Imposing these significant costs on NPMs dampens the Majors' typical incentives to engage in vigorous price competition. Two key features of the MSA directly dampen these incentives. First, the imposition of costs on NPMs enables the Majors to pass on a significant amount of their MSA costs to consumers in the form of higher prices without fear

that the smaller manufacturers will undercut the Majors' market share and profit margins. Second, the MSA effectively guarantees small manufacturers a stable market share equal to 125 percent of their 1997 market share but strongly discourages them from expanding beyond that level. Under these conditions, the Majors have a greater incentive to increase prices because their rivals have a reduced incentive to expand sales. In other words, by requiring even NPMs to pay into an escrow fund, the government has eliminated the ability of the NPMs to compete with the Majors by undercutting their prices, which would be an unambiguous benefit to consumers. In turn, the Majors concede a modest increase in the market share of small manufacturers in exchange for the ability to raise prices free from the threat of losing a much larger market share. The MSA represents a coordinated effort of the States, the Majors, and other participating manufacturers to increase cigarette prices.

The competitive consequences of cartels are both predictable and intended: prices and cartel profits increase while consumer welfare falls. Far from penalizing the Majors, the anticompetitive features of the MSA, such as its limits on advertising and facilitation of coordinated pricing, produced supra-competitive profits and dramatic increases in their stock prices. See Frank A. Sloan et al., Impacts of the Master Settlement Agreement on the Tobacco Industry, 13 Tobacco Control 356 (2004) (demonstrating that tobacco industry firms experienced abnormal positive stock returns post-MSA); Stuart J. Fowler & William F. Ford, Has a Quarter-Trillion Dollar Set-

tlement Helped the Tobacco Industry?, 28 J. ECON. & FIN. 430, 433-34 (2004) (finding that the MSA "induces anticompetitive behavior" by facilitating coordinating pricing which "may more than fully compensate for the external costs smokers impose on nonsmokers"). The empirical evidence suggests that the MSA changed the nature of competition in the tobacco industry from the price war period following the so-called "Marlboro Friday" price war of April 3, 1993, which had led to lower cigarette prices, to a consistent increase in prices in the post-MSA period. For example, one economic study found that although the MSA resulted in only a 44 cent per-pack tax on cigarettes, overall prices for cigarettes increased by more than one dollar. See Federico Ciliberto & Nicolai V. Kuminoff, Public Policy and Market Competition: How the Master Settlement Agreement Changed the Cigarette Industry, 10 B.E. J. OF ECON. ANALYSIS & POL'Y (2010). The authors conclude that the evidence "supports the hypothesis that the [MSA] acted as a coordinating device for firms to collectively end their price war and raise cigarette prices." Id. at 39. Moreover, prior research has found that the overall health effects of higher cigarette prices are ambiguous or even counterproductive, as higher prices lead smokers to essentially seek "more bang for their buck" by switching to cigarettes that are higher in tar and nicotine and adjusting their smoking style in order to extract more nicotine from each cigarette. See Jerome Adda & Francesca Cornaglia, Taxes, Cigarette Consumptions, and Smoking Intensity, 96 AM. ECON. REV. 1013 (2006); Matthew C. Farrelly et al., The Effects of Higher Cigarette Prices on Tar and Nicotine Consumption in a Cohort of Adult Smokers, 13

HEALTH ECON. 49 (2004); William N. Evans & Matthew C. Farrelly, The Compensating Behavior of Smokers: Taxes, Tar, and Nicotine, 29 RAND J. ECON. 578 (1998).

As predicted by economic theory, the MSA dampens the incentive for price competition by the Majors against the subsidized smaller manufacturers, resulting in stabilized market shares, increased industry profits, and price increases much larger than justified by the increase in costs or predicted under competitive conditions. The MSA and the escrow statutes combine to ensure a national cigarette cartel. Economic theory accurately predicts corresponding welfare transfers from consumers to the tobacco industry and states through higher profits and tax increases.

Further, economics teaches that public restraints on trade – cartels in which the government plays a role of participant or enforcer – have the most pernicious consequences for consumers because they are more likely to be immunized from the competitive pressures of entry that discipline private restraints of trade. See Harold Demsetz, Two Systems of Belief About Monopoly, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING (H. Goldschmid et al., eds, 1974). The National Industrial Recovery Act (NIRA) and the National Recovery Administration (NRA) present historic examples of government-sponsored cartelization of industry in the United States. The NIRA and NRA helped industries create and enforce so-called industry codes. Economic evidence overwhelmingly shows that cartel arrangements facilitated by government action slowed recovery from the Great Depression, seriously harming consumers and the economy as a

whole. See Jason Taylor, Cartel Code Attributes and Cartel Performance: An Industry Level Analysis of the National Industrial Recovery Act, 50 J. L. & ECON. 597 (2007); Harold Cole & Lee Ohanian, New Deal Policies and the Persistence of the Great Depression: A General Equilibrium Analysis, 112 J. POL. ECON. 779 (2004); Christina Romer, Why Did Prices Rise During the 1930s?, 59 J. ECON. HIS. 167 (1999). The MSA-inspired cartel imposes similar effects: Majors and the states gain profits and tax revenues; consumers pay higher prices and lose choices. Indeed, as Judge Ralph Winter observed in his review of the MSA in Freedom Holdings v. Spitzer, the MSA was a contract initially agreed to by the Majors, which originally sought congressional ratification of the bargain through a formal antitrust exemption. Freedom Holdings I, 357 F.3d at 224. It was only after Congress refused to carve out an exception to the antitrust laws to protect the Majors' cartel that they turned to an interstate agreement of state governments instead.

II. Parker Immunity is Justified Only When It Comports With Principles of Competitive Federalism.

The state action doctrine is grounded in principles of federalism. See Parker, 317 U.S. at 341; Federal Trade Commission v. Ticor Insurance Co., 504 U.S. 621, 633 (1992) (noting that "our decision [in Parker] was grounded in principles of federalism."). As the Report of the State Action Task Force of the Federal Trade Commission observed, "although the Court has held that the state action doctrine is grounded in principles of federalism, it has never fully explained

how federalism justifies the current form of the defense." FED. TRADE COMM'N, REPORT OF THE STATE ACTION TASK FORCE 5 n.4 (2003) [hereinafter "FTC State Action Report"]. The present case provides the Court an important opportunity to clarify this doctrine by declaring that while Parker immunity may grant a state the power to adopt an anticompetitive regulatory policy within its own borders, the principles of competitive federalism upon which the immunity is grounded require that it not be extended to reach multi-state agreements that facilitate a national cartel. Recently, the bipartisan Antitrust Modernization Commission, noting that the federalism principles of the state action exception counsel that caution where political accountability is attenuated, concluding that "[w]here the effects of potentially immunized conduct are not predominantly intrastate, courts should not apply the state action doctrine." See ANTITRUST MODERNIZATION COMM., RECOMMENDATIONS AND REPORT 346 (April 2007); FTC State Action Report, at 44 ("[S]pillovers undermine both economic efficiency and some of the same political representation values thought to be protected by principles of federalism.").

This Court's state action jurisprudence has recognized that just as private markets can fail, thereby justifying regulatory intervention (including antitrust scrutiny), political markets can fail as well, resulting in the special-interest capture of the regulatory process. Accordingly, this Court has progressively narrowed the scope of the state action doctrine and stressed the importance of linking the protection of

the state action exception to values of federalism and political accountability.

This justification draws upon the logic of competitive federalism as established by the American constitutional system. Competitive federalism operates as a crucial check on special interest activity conducted under the guise of the state action doctrine. While the state action doctrine permits states to opt-out of the regime of robust private ordering and competition embodies in the Sherman Act, for that dynamic process to work properly, it is crucial that the state actors that enact anticompetitive regulations bear the full costs of those policy decisions.

Competitive federalism serves two related functions in the American constitutional system. First, it provides a mechanism for individuals to sort themselves into different communities so as to match their personal preferences with different mixes of governmental services, taxes, and regulations. See Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. POL. ECON. 416 (1956); Friedrich A. Hayek, The Economic Conditions of Interstate Federalism, NEW COMMONWEALTH Q. (Sept. 1939), reprinted in FRIEDRICH A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER 255 (1948). A citizen-consumer who prefers a mix of high taxes and high governmental services may select that combination; others may select lower taxes and services. Some might prefer metropolitan areas with high-density economic and residential development; others may prefer to a more suburban or rural environment.

The mirror proposition is true as well: just as competitive federalism permits people to opt in to the

communities that they prefer, it also allows them to opt out of, or exit from, jurisdictions that fail to match their preferences or which provide governmental services inefficiently. See Richard A. Epstein, Exit Rights Under Federalism, 55 LAW & CONTEMP. PROBS. 147 (1992). In particular, competitive federalism provides a crucial constraint on rent-seeking and special interest activity at the state and local levels by enabling citizens to vote with their feet to escape inefficient or oppressive governmental regimes.

As James Madison noted in Federalist 51, "In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself." Thus, the challenge of constitutional design is to simultaneously prevent special interest factions from influencing the government for their own ends while also constraining agency costs by governmental officials tempted to use the power of their office to promote their own narrow ends. Madison further notes that the resolution of this tension resides in the final place on the people—"a dependence on the people is, no doubt, the primary control on the government"—but that "experience has taught mankind the necessity of auxiliary precautions."

The most important of these auxiliary precautions are the twin structural pillars of the Constitution: separation of powers and federalism. At the federal level, separation of powers raises the costs and increases the difficulties for special interests and governmental officials to combine in schemes of improper legislation at the expense of the public. Competi-

tive federalism provides the same check at the state level—to establish a system of competition that constrains special interest activity by forcing state politicians to bear the political costs of their decisions. Competitive federalism in turn ameliorates the economic costs of legislative rent-seeking by enabling those otherwise forced to subsidize special-interest legislation to exit by moving to states with more efficient and effective policies. As Justice (then-professor) Scalia observed, the constitutional value of federalism is the promotion of freedom and open markets. Horizontal competitive federalism can be a powerful instrumentality for these ends. Antonin Scalia, The Two Faces of Federalism, 6 HARV. J. L. & PUB. POL'Y 19 (1982).

The general applicability of the Sherman Act and the principle of free competition it embodies is itself a powerful example of the use of vertical federalism to promote interstate commerce and competitive markets and to "restrain the centrifugal tendencies of the states." Id. at 20-21. Federalism's value as a constitutional principle, therefore, is to balance individual liberty, competitive markets, and the reduction of special-interest factions on one hand against a state's legitimate regulatory interests on the other. If states can simply band together to thwart important federal and constitutional policies, however, federalism will be perverted into a tool for restraint on liberty and the promotion of interest-group rent-seeking. As Justice Scalia has remarked, federalism "is a stick that can be used to beat either dog"—the states or federal government—as necessary in order to promote individual liberty and mitigate interest-group factional-

ism. Id. at 19. The judicious use of the Sherman Act's preemptive powers over anticompetitive state laws is an example of Congress's power to promote this constitutional balance.

Research has shown that competitive federalism provides a powerful check on the ability of state governments to raise taxes on cigarettes. Cigarette taxes target a relatively small group of citizens with a relatively inelastic demand for the taxed product; this inelastic demand generates a temptation for government officials to force smokers to bear a disproportionate tax burden for the provision of general governmental services. Competitive federalism limits the ability of governmental officials to disproportionately raise taxes upon this disfavored minority by enabling smokers at the margin to cross state boundaries to purchase cigarettes. See Daniel K. Benjamin & William R. Dougan, Efficient Excise Taxation: The Evidence from Cigarettes, 40 J. L. & ECON. 113 (1997).

The tobacco MSA attempts to extend the state action exception well beyond its logical federalist limits. Parker immunity has never been extended, and should not now be extended, to a national agreement with significant effects on firms and consumers nationwide. By facilitating an interstate cartel for tobacco, the MSA eliminates the constraints of competitive federalism, forming a cartel that enables the Majors to raise prices free from market competition and enables the states to raise taxes and engage in special-interest bargains free from interstate competition. These increased prices are parceled out by both wings of the cartel: PMs enjoy increased profits; state officials gain additional revenues to fund general go-

vernmental operations and funnel hundreds of millions of dollars to a hand-picked group of politically-connected lawyers who recycle some of those riches back to state officials in political donations. See W. KIP VISCUSI, SMOKE-FILLED ROOMS: A POSTMORTEM ON THE TOBACCO DEAL 55 (2002) (discussing trial lawyers' efforts to "protect their windfalls gains and to promote their interests in future cases" with campaign contributions).

Just as private market actors prefer the quiet life of a cartel to the rivalry of competition, state politicians prefer to enact laws that further their reelection efforts and reward powerful special interests without having to worry about other states undercutting them with more efficient laws.

The MSA solves the "cheating" problem plaguing most state efforts to create cartel arrangements in goods such as cigarettes that would otherwise arise because one state would be tempted to reduce its taxes in order to draw more transactions to its state. The MSA protects state politicians from the natural consequences of their actions by creating an interstate compact, thereby enabling each state's politicians to raise taxes on consumers to fund general operations without fear of competition from other states. The interstate nature of the MSA to protect states from competition is at root no different from private market cartelists agreeing not to compete. In the end, consumers lose from both types of cartels.

The state action exception to the antitrust laws is rooted in federalism as a theory of state power: that state officials should have the discretion to compromise the presumptive value of competitive markets

and individual liberty where they decide that other regulatory goals should predominate. But implicit in this theory is the equally important recognition of competitive federalism as a check on excessive agency costs and special interest factionalism. Under the MSA, by contrast, the states assert the authority to engage in a government-facilitated and enforced cartel with the Majors to create and share monopoly profits—and, importantly, to do so while simultaneously eliminating the constraints of competitive federalism. To the extent that the states seek the shelter of the state action doctrine to protect cartels that they create, this Court has made it clear that the states must also accept the constraints of federalism as well. Thus, while this Court has recognized legitimate state action as an exception to the Sherman Act when a state imposes, supervises, and otherwise takes responsibility for, a clearly articulated policy to implement an anticompetitive policy, it has not extended Parker immunity to state programs facilitating a nationwide cartel generating significant out-of-state supracompetitive profits and consumer harms. This limit on the state action exception follows logically from the federalist roots of the doctrine itself—where the state facilitates a national cartel with pernicious economic effects at the national level, political accountability breaks down, and with it the justification for state action immunity from the Sherman Act. This Court has never applied the protection of the state action doctrine to a multi-state agreement. Nor should it start now.

CONCLUSION

For the reasons above, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

C. BOYDEN GRAY
(Counsel of Record)
GRAY & SCHMITZ, LLC
1627 I St NW
Suite 950
Washington, DC 20006
(202) 955-0620

Counsel for Amicus Curiae

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No. 10-622

In The
Supreme Court of the United States

S&M BRANDS, INC., TOBACCO DISCOUNT HOUSE #1, AND MARK HEACOCK,
Petitioners,

v.

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,
Respondent.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Fifth Circuit

AMICUS CURIAE BRIEF OF CONSTITUTIONAL LAW SCHOLARS IN SUPPORT OF THE PETITION

ALAN B. MORRISON
THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL
2000 H STREET NW
Washington, DC 20052
(202) 994-7120
(202) 994-5157
abmorrison@law.gwu.edu

Counsel for Amici Curiae

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INTEREST OF *AMICI CURIAE*[1]

Amici are law professors who have taught, written about, and litigated cases involving various aspects of constitutional law.[2] They are submitting this brief in support of the petition because they believe that the lower courts in this and other similar cases have not properly understood the meaning of the Compact Clause of Article I, section 10 and have not understood its place in the federalism provisions of the Constitution. They take no position on whether the Master Settlement Agreement (MSA) being challenged in this case creates a sound public policy, but they do believe that the MSA is subject to the Compact Clause and that to allow States and private companies to enter an agreement of this type and with this massive impact, without approval of Congress, threatens to create an imbalance in our federal system. That imbalance can produce serious harms to both non-participating States and the Federal Government, in addition to the economic harm to competitors of the tobacco companies that are parties to the MSA and to consumers of tobacco products. The brief is being filed pursuant to a blanket consent given by all counsel and filed with this Court. Notice pursuant to Rule 37 was provided to all counsel on November 20, 2010.

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[1] No person other than the named *amici* authored this brief or provided financial support for it.

[2] Alan B. Morrison is the Lerner Family Associate Dean for Public Interest and Public Service at the George Washington University Law School; Richard Epstein is the Laurence A. Tisch Professor of Law at New York University Law School; and Kathleen M. Sullivan is the Stanley Morrison Professor of Law and Former Dean at Stanford Law School.

STATEMENT OF THE CASE

The complaint in this case challenges the legality of what is known as the Master Settlement Agreement (MSA) between the major tobacco manufacturers and 46 states, as described more fully in the petition. The legal bases for that claim are the Sherman Antitrust Act, 15 U.S.C. § 1, and the Compact Clause of Article I, section 10 of the Constitution. As the case comes to this Court, it is undisputed that the MSA violates the Sherman Act and that the petitioners would be entitled to an injunction against its continued operation unless the agreement is shielded by this Court's decision in *Parker v. Brown*, 317 U.S. 341 (1943). That decision found an implied exception to the antitrust laws for what would otherwise be a private agreement in restraint of trade, where the agreement was approved by the State, pursuant to a legislative policy that replaced competition with regulation, provided that the State actively supervised the operation of the agreement.

Petitioners argue that *Parker* does not apply to the MSA, but even if it did, the MSA would still be unlawful because it has not been submitted to, let alone approved by, Congress as required by the Compact Clause. *Amici* agree that *Parker* does not protect the MSA from antitrust scrutiny for two related reasons. The Compact Clause contains a specific method by which multi-state agreements can be lawfully implemented. Respondent's position is that, in addition to the implied exception under *Parker* for decisions of individual States to replace competition with regulation, Congress also impliedly exempted multi-state agreements that supplant competition in the agreeing States. But that argument is wholly inconsistent with the affirmative requirement in the

Compact Clause that all such agreements be permitted only if approved by Congress.

Second, even if *Parker* explicitly included multi-state exceptions to the Sherman Act, the specific Compact Clause mandate of Congressional approval for agreements such as the MSA overrides any such exception, and hence would render the MSA invalid under the Compact Clause. It is common ground that not every agreement between two or more states must be approved by Congress, but only those that improperly increase the powers of the States that agreed to it. Thus, the applicability of the Compact Clause in this case depends on a proper understanding of that Clause and of the operation of the MSA.

The court of appeals below, agreeing with other courts that have heard similar challenges, found the Compact Clause inapplicable because "the MSA only increases states' power *vis-à-vis* the [manufacturers that are also parties to the MSA] and not in relation to the federal government." Pet. App. A6. That ruling, which effectively disregards the impact of the MSA on the federal government, other States, and third parties such as petitioners, is based on a serious misunderstanding of the meaning and scope of the Compact Clause. Accordingly, this brief will first establish the proper meaning of the Compact Clause and then explain why, as correctly understood, it requires that the MSA be approved by Congress.

ARGUMENT

THE LOWER COURTS, BY NARROWLY READING THIS COURT'S DECISION IN *UNITED STATES STEEL*, HAVE IMPROPERLY RELEGATED THE COMPACT CLAUSE TO A STATUS OF VIRTUAL INSIGNIFICANCE.

The Compact Clause is one of a number of provisions in the Constitution that speaks to issues of federalism by allocating powers between the States on the one hand and the Federal Government on the other. As such, it can be best understood not simply on its own, but as part of the federalism provisions.

At the time of the framing, the basic principle underlying the Constitution was that the primary lawmaking authority rested with the States and that the Congress was given the power to enact laws only as specifically authorized, mainly in Article I, section 8, and even then subject to the prohibitions of section 9 and others specified elsewhere in the Constitution. Having lived through the period when the Articles of Confederation spelled out the relations among the States, and between them and the central government, the Framers recognized that Congress needed certain powers and that the States should be forbidden from carrying out certain activities, either absolutely or without the approval of Congress. The foremost among the new congressional powers is that contained in Article I, section 8, clause 3, "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Although originally conceived as a limited power, the reach of the Commerce Clause has expanded greatly since 1789, and it now extends to activities that are

wholly intra-state and not necessarily commercial, so long as Congress reasonably concluded that those activities might have a substantial impact on interstate commerce. *Gonzales v. Raich*, 545 U.S. 1 (2005). It is the Commerce Clause that is the basis for the Sherman Act relied on by petitioners for that cause of action.

This Court has also ruled that the affirmative grant of power to Congress to regulate commerce also contains in it a "dormant" or negative power that forbids States, even without Congressional action, to enact laws that substantially burden interstate commerce, often by discriminating against out of state entities. *See also* Article IV, section 2, clause 1, further preventing State-based discrimination by guaranteeing to all citizens "all Privileges and Immunities of Citizens in the several States." Moreover, if there is a conflict between the Sherman Act and/or the Compact Clause, and the laws of Louisiana that respondent is enforcing, such as the MSA, the Supremacy Clause of Article VI, section 1, clause 2, provides that the federal law "shall be the supreme Law of the Land."

Although this case involves limits on the powers of the States, it is important to keep in mind that there are also limits on the powers of the Federal Government. For instance, the President's powers are specified in Article II, as well as those delegated to him by Congress in duly enacted laws. Although he has some inherent powers not spelled out in the Constitution, they are limited in the domestic area and may not conflict with powers assigned to others. *See Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952). Similarly, the federal courts are not courts of general jurisdiction, but can hear only cases

in the nine categories spelled out in Article III. The Tenth and Eleventh Amendments impose further limits on the Federal Government, and even Section 5 of the Fourteenth Amendment, which gives Congress "the power to enforce, by appropriate legislation, the provisions of this article," has been construed by this Court to limit such legislation to remedying violations of that Amendment. *United States v. Morrison,* 529 U.S. 598, 619-27 (2000).

The first eight amendments were originally made applicable only to the Federal Government, but with the enactment of the Fourteenth Amendment's Due Process and Equal Protection Clauses, and this Court's widespread incorporation of the rights in the Bill of Rights into the Fourteenth Amendment, most, although not all of those amendments, are also applicable to the States. *See McDonald v. City of Chicago,* 130 S.Ct. 3020 (2010).

The Compact Clause is one of several provisions in the original Constitution that expressly limit the powers of the States for the purpose of protecting the interests of the United States as a whole, in situations where the States and the Federal Government may have different views on those interests. Under Article I, section 4, the "Times, Places and Manner of holding elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof, but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators." Pursuant to this authority, Congress has decided that all elections for federal officials should be held on the first Tuesday after the first Monday in November, 2 U.S.C. § 7, because the national interest in having a single day for federal elections outweighs any State

interest in choosing their own election days. Similarly, even though the elections for Members of Congress are done on a State by State basis, if there is dispute about who has prevailed, section 5 of Article I provides for a method of resolving those disputes: the House of Congress to which the candidates are seeking election is the final decision maker. And pursuant to the third clause of Article II, section 1, if there are disputes arising from the States' selection of Presidential electors, they are to be resolved by the House of Representatives.

The Compact Clause is set forth in the third set of prohibitions in Section 10 of Article I. *See generally*, Laurence H. Tribe, *American Constitutional Law*, 1238-42 (3rd ed., Vol. 1) (2000); Duncan B. Hollis, *Unpacking the Compact Clause*, 88 Texas L. Rev. 741, 759-66 (2010) (detailing the history and rationales for parts of section 10). The first group contains absolute bars to certain actions by the States. Some duplicate prohibitions that are applicable to Congress – no Titles of Nobility, bills of attainder, or ex post facto laws – while others are included because the functions are assigned exclusively to the National Government on the theory that these are areas where a single voice should be heard or uniformity is essential. These include the ban on entering "any Treaty, Alliance or Confederation," coining money, or making anything but gold or silver legal tender for the payment of debts. The second group deals with imports and exports, particularly the taxing thereof, but permits States to engage in otherwise prohibited activities, with the consent of Congress. However, it also provides that all net revenues shall belong to the United States Treasury and that even the laws that Congress approves are subject to

congressional revision. In short, for this second group, Congress may consent, but the Clause has conditions that apply even with congressional approval.

The third group mainly contains broad prohibitions of conduct by a State, absent the consent of Congress, but with no mandatory conditions that accompany such consent. The provision at issue in this case does not apply to acts by a single State, but bars States from entering "any Agreement or Compact with another State, or with a foreign Power," again without the consent of Congress. While section 10 as a whole reverses the basic presumption of the Constitution that States are free to engage in acts normally incident to sovereignty as to the activities set forth in it, the Compact Clause in clause 3 reflects a special concern about, and dictates specially-disfavored treatment for State activities with other governments – both domestic and foreign – that constitute an "Agreement or Compact." Thus, the existence of an inter-state Compact acts as a kind of danger signal that further congressional action may be required.

But if the Compact Clause were read literally to apply to "any" agreement between two States on any subject, that could impose serious burdens and delays on States, and in some cases absurd results, any time they cooperated with a sister State. *See Virginia v. Tennessee*, 148 U.S. 503, 518 (1893) (giving examples of literal application of Compact Clause in cases in which it would be the "height of absurdity" to require approval of Congress). Rather, like the use of "any" in the Sherman Act, "any" in the Compact Clause is not read literally, and it is undisputed that many kinds of agreements are not subject to advance congressional approval, even if they meet the

literal definition of an agreement for other purposes, such as contract law.

This Court has had relatively few cases in which it has opined on this distinction, the most recent being *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452 (1978), in which it found that the arrangement at issue there, relating to income taxation for corporations doing business in more than one State, did not fall within the strictures of the Compact Clause.[3] Several features of that multistate arrangement supported that ruling. The tax enforcement policies resulting from that agreement were advisory only since no State was obliged to adhere to them. The agreement had no impact on any federal law or program as it applied only to taxes imposed by States and localities. It did not produce adverse effects on the tax laws of States that chose not to join it, and a signatory State could withdraw at any time without cause or penalty. In short, it was a cooperative arrangement that did not produce any cause for concern for interests governed by our federal system, although it undoubtedly had some adverse effects on United States Steel and other companies whose tax issues may have been less favorably resolved as a result of the voluntary adherence, or as the Court put it, the "interstate cooperation," *id.* at 465, of the signing States.

United States Steel is significant for what kinds of agreements are outside the Compact Clause, but it does not do much to answer the question of

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[3] Justice White, joined by Justice Blackmun, dissented on the ground that the majority's reading of the Compact Clause was too narrow and that it allowed too many interstate compacts to escape congressional review. *Id.* at 479-96.

what kinds of agreements fall within it. In the more than 32 years since then, this Court has not provided guidance on that question, although the Justice Department's Office of Legal Counsel issued a well-reasoned opinion two years after *United States Steel* that expressed its views on both which arrangements were outside the Clause and which were within it. Applicability of Compact Clause to Use of Multiple State Entities Under the Water Resources Planning Act, 4B Op. Off. Legal Counsel 828 (1980). In contrast to the lower court opinion in this case and in others challenging the MSA, OLC did not limit the application of the Clause to actual harms to federal interests, but extended its reach to potential impairments to the enforcement of federal laws and policies and to the interests of States and private parties that are not signatories to an agreement. Thus, according to OLC, "[i]nterstate agreements interfere with federal power in this sense [of interfering with the supremacy of the United States] if: (1) they involve a subject matter which Congress is competent to regulate, *see Wharton v. Wise,* 153 U.S. 155, 171 (1894); and (2) they purport to impose some legal obligation or disability, *see United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 467-71 (1978)." *Id. at 830-31.* OLC also stated that agreements among States are subject to the Compact Clause if they "impose a legal detriment on state or federal governments or private parties, *id.* at 831, and such agreements are not excluded unless "each state is free to accept or reject a [a decision made pursuant to it] or any of its provisions and has the unfettered right to withdraw" from them. *Id.*

The opinion further emphasized the need for continued State independence if an agreement is to

be excluded: if the agreement "is made instead in return for reciprocal action by other states," then it would be covered by the Clause. *Id.* Moreover, consent of Congress would be required if an entity created by an agreement "possessed any legally effective authority, regulatory or otherwise, to ensure the [agreement's] implementation by state or federal governments or private parties." *Id.; see also Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 472 U.S. 159, 175 (1985) (reciting similar factors in determining whether certain reciprocal State statutes fall within Compact Clause, but finding the question unnecessary to decide because State statutes that comply with specific federal legislation in this area "cannot possibly infringe federal supremacy", *id.* at 176).

As spelled out in detail in the petition, the MSA fails every one of OLC's tests for exclusion from the Compact Clause and meets every one for inclusion. It operates in an area that is not only appropriate for federal regulation, but it does so in the antitrust field in which Congress has enacted far-reaching and economically significant regulations that touch virtually every area of the country's economic life. Indeed if respondent and the lower courts are correct that the actions of the 46 States in joining the MSA constitute an absolute defense to this action, then it would equally be a defense to a similar action brought by the Department of Justice challenging it under the Sherman Act. The notion that an agreement among a group of States that authorizes price fixing and market-share divisions, as the MSA does, can stop federal enforcement of the antitrust laws in its tracks, is almost unthinkable in its own terms. But the Compact Clause takes that pos-

sibility from the unthinkable to the unconstitutional because the MSA is precisely the kind of joint State interference with federal laws that the Clause was designed to preclude by requiring congressional approval for agreements of this type. Indeed, in *Virginia v. Tennessee, supra,* this Court held that an agreement to settle a boundary dispute between two States required approval of Congress under the Compact Clause, even though the principal effects of that settlement were on the two settling States. 148 U.S. at 519-21.[4]

But even in the absence of federal antitrust laws, the MSA is forbidden because it is not the kind of cooperative arrangement excluded either in *United States Steel* or the OLC Opinion since it has all of the factors identified in those authorities as indicative of agreements requiring congressional approval. First, the 46 States that joined the MSA are bound by all of its terms and are also explicitly forbidden from withdrawing from it, in contrast to the MTC in *United States* Steel, which States did not have to follow and from which they were permitted to withdraw at any time. Second, because the payments under the MSA are determined by market share nationwide, tobacco users and sellers in the four States that are not parties to the MSA are also affected by it. Third, consumers of tobacco products (such as petitioner Mark Heacock) have seen the price of those products rise as

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[4] The Court then ruled that Congress had impliedly approved the compact by subsequent legislation regarding collection of revenues and representation in Congress by utilizing the agreed-upon boundaries as the basis for laws enacted by Congress. *Id.* at 521-22. *But see New Hampshire v. Maine,* 426 U.S. 363 (1976) (finding settlement of last vestiges of dispute under earlier decree not subject to Compact Clause).

a direct result of the obligations and authorities granted by the MSA, not by a decision of the State in which they make their purchases.

Fourth, as a result of the States' implementation of the MSA, including their own statutes required by the MSA, the competitors of the participating manufacturers (such as petitioner S&M Brands) are required to make additional payments into state-specified escrow accounts to offset the payments that the major tobacco companies agreed to pay the States to compensate them for the damages that the tobacco companies had caused. The effect of that requirement is to force those competitors to increase the price of their products to consumers in order to protect their profit margins, thereby protecting the market share of the major tobacco companies. Fifth, the MSA creates a separate legal entity, known as the Firm, that issues binding legal opinions and orders to which all States must adhere. Sixth, the State of Louisiana, whose Attorney General is the respondent in this case, has enacted these provisions into a law that cannot be amended without violating the MSA. And finally, the MSA itself makes clear that it will work only if all 46 States that had not previously settled with the tobacco defendants signed on, thus creating reciprocal rather that individual State actions. *See also United States Steel, supra,* 434 U.S. at 470, stating that even reciprocal legislation without a formal agreement might be subject to the Compact Clause if it may "present opportunities for enhancement of state power" of the kind that the Clause requires be approved by Congress.

Under the Compact Clause, an agreement to surrender State sovereignty to a reciprocal binding set of obligations or an agreement among States that

adversely impacts federal interests triggers the need for approval of Congress. *United States Steel, supra,* 434 U.S. 471 ("relevant inquiry must be one of impact on our federal structure"). But in this case, the MSA meets both prongs, and therefore it presents an exceptionally strong case for Compact Clause review. All of the reasons noted above why the federal sovereignty prong is met establish that there is not merely the possibility of harm to the federal interest in enforcing the antitrust laws, but that the MSA directly replaces the federal norm of competition with a horizontal agreement to fix prices and divide markets under the direction of the major tobacco companies, with 46 State governments using the MSA to assure that competition is not restored. It is difficult to imagine any arrangement more inimical to the antitrust laws, and hence one for which a *Parker* exemption is less suited, let alone more suited for scrutiny as an "Agreement or Compact with another State," requiring congressional approval under the Compact Clause.

Despite this contrary authority, the court of appeals below, echoing the prior rulings of other courts, concluded that the Compact Clause was inapplicable because "the MSA only increases states' power *vis-à-vis* the [manufacturers that are also parties to the MSA] and not in relation to the federal government." Pet. App. A6. To be sure, the tobacco companies that are participants in the MSA are bound by it, and hence, under traditional contract law principles, their powers are limited because of their agreement with the States. But that can be said of every party to every contract, and, therefore, that conclusion either overlooks the substantial effects of the MSA on non-parties, including but not

limited to the Federal Government, or it fails to understand that it is precisely those effects that the Compact Clause was designed to control by requiring approval by Congress of multistate agreements such as the MSA.

There is one other aspect of the MSA that makes it particularly pernicious. The tobacco companies included in the MSA a provision that no individual State would ever voluntarily support: the MSA had to be ratified by each State's legislature, and it had to bind not only the current State officials, but all future holders of those offices. Perhaps as a matter of some States' laws, that provision could not prevent the State from repealing its law agreeing to the MSA, but repeal would result in severe penalties imposed by the MSA for doing so. Even if withdrawal were possible as a matter of State law, current and future State officials would almost certainly claim that their hands were tied economically, if not legally, and thus they could do nothing to stop the participating tobacco companies from charging monopoly prices. It is only because 46 States joined the MSA that such a surrender of accountability and loss of democratic control by future State officials could take place, thereby providing another reason why Compact Clause approval is necessary. If Congress were to approve the MSA, at least there would be identifiable officials who would be accountable and to whom those who were being harmed by a congressionally-approved MSA could look to seek a repeal or modification of that approval. Furthermore, there would be no possibility of precluding future Congresses from repealing its approval prospectively since it is hornbook law that one Congress can not bind a future Congress, except by amending the Constitution.

United States v. Winstar Corp., 518 U.S. 839, 872 (1996) (quoting 1 W. Blackstone, Commentaries on the Laws of England 90 (1765)).

There is, of course, a reason why 46 States joined the MSA and agreed to eliminate competition in the pricing of cigarettes and to impose what is, in effect, a hidden tax on consumers of tobacco products: they were guaranteed to be paid billions of dollars over 25 years at a time when their budgets were in serious trouble and raising taxes would be politically hazardous to those seeking re-election. To be sure, the litigation against the major tobacco companies had produced very damaging evidence and four States had already obtained substantial monetary settlements, although none was based on anything like the MSA formula that relies on State-enforced suppressed competition to generate the funds used to make the annual payments to the States. There is nothing in the Compact Clause that would have prevented all 46 States from settling with the tobacco companies that had committed the wrongful conduct that made them responsible for the damages caused from the use of tobacco products, including a provision allocating the recovery among the States pursuant to an agreed-upon formula. Even if the parties agreed to have the payments spread over the future, so long as the amounts were calculated based on prior conduct, there would be no need for Compact Clause approval. But when States enter binding agreements to conduct themselves in certain ways in the future, that is a very different situation for Compact Clause purposes. And when there are very significant impacts on third parties and on the ability of

the Federal Government to enforce the antitrust laws, approval of Congress is required.[5]

A word about the approach taken by the lower courts to the Compact Clause. Instead of the robust provision that reverses the presumption that the States can pass whatever laws they want, unless expressly forbidden or preempted by federal law, the narrow view of the court of appeals on the Compact Clause means that it is essentially duplicative of the Supremacy Clause since nothing is required of States that wish to enter inter-state compacts except when they would be otherwise forbidden by federal law. Whatever the limits of the Compact Clause may be, it has a far larger role in assuring that agreements among States, such the MSA, do not interfere with overall federal interests and do not have significant impacts on other States and private persons.

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[5] An earlier settlement between various States and the major tobacco companies was submitted to Congress, but not acted on before it was withdrawn. Petition at 10. *Amici* recognize that a request to approve an agreement does not imply that the agreement is required to be submitted under the Compact Clause. *United States Steel, supra,* 434 U.S. at 458 n. 8 (submitted agreement, never approved, held not subject to Compact Clause). What is relevant about that prior submission is that the Federal Trade Commission raised serious antitrust objections to it and concluded that it would produce additional profits for the companies far in excess of the money needed to fund the settlement. *Id* .at n.6. Thus, it is far from clear that Congress would have approved the revised and much broader MSA.

* * *

This Court has not heard a Compact Clause case in more than 25 years since it decided *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 472 U.S. 159, 162 (1985) (granting review in absence of a conflict because of importance of issues presented under the Commerce and Compact Clauses). The petition here presents a clear opportunity to consider the reach of that Clause in the context of an agreement that directly impacts and, we would argue, directly interferes with, the enforcement of the antitrust laws that are vital to maintaining free and open competition in the United States. The MSA affects a major industry and effectively permits the tobacco companies to engage in perpetual price-fixing and allocation of market shares, with the States precluded by the MSA from objecting or backing away from their agreement and by the massive annual payments on which they have become dependent. If this agreement is allowed a free pass, States will see it as a sign that they can be even more aggressive in substituting their judgments for those of Congress as to the national interest in matters that have significant consequences outside their borders. The Compact Clause reverses the basic presumption that the States are free to take whatever actions they want unless disapproved by Congress, by requiring congressional approval for significant interstate agreements. The Court should grant review in this case to make it clear that far-reaching agreements, like the MSA, must be approved by Congress and that the failure to obtain that approval here makes them unenforceable.

CONCLUSION

The petition should be granted.

Respectfully submitted,

ALAN B. MORRISON
(Counsel of Record)
THE GEORGE WASHINGTON
UNIVERSITY LAW
SCHOOL
2000 H STREET N.W.
Washington, D.C. 20052
(202) 994-7120
(202) 994-5157 (fax)
abmorrison@law.gwu.edu

Counsel for Amici Curiae

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IN THE

Supreme Court of the United States

S&M BRANDS, INC.,
TOBACCO DISCOUNT HOUSE #1, and MARK HEACOCK,

Petitioners,

—v.—

JAMES D. "BUDDY" CALDWELL, in his official capacity as Attorney General of the State of Louisiana,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* ON BEHALF OF FREEDOM HOLDINGS AND INTERNATIONAL TOBACCO PARTNERS LTD. IN SUPPORT OF PETITIONERS

DAVID F. DOBBINS
Counsel of Record
NICOLAS COMMANDEUR
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, New York 10036
(212) 336-2000
dfdobbins@pbwt.com
ncommandeur@pbwt.com

QUESTIONS PRESENTED

Forty-six States and numerous tobacco companies have signed an irrevocable agreement, called the Master Settlement Agreement ("MSA"), which divides markets, suppresses price competition, and restricts competitive advertising, with the purpose and effect of increasing both tobacco company profits and state revenues. It is undisputed that this agreement would violate the antitrust laws if entered into by the tobacco companies alone. The questions presented are:

1. Whether a binding agreement among multiple States and private companies is immunized from antitrust scrutiny under the state-action immunity doctrine of *Parker v. Brown*, 317 U.S. 341 (1943).

2. Whether a binding agreement among multiple States, with both intrastate and interstate effects, violates the Compact Clause, Article I, § 10, cl. 3 of the United States Constitution, in the absence of congressional approval.

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INTEREST OF *AMICI CURIAE*[1]

Freedom Holdings and International Tobacco Partners Ltd. are importers of cigarettes made by firms that do not belong to the Master Settlement Agreement, defined in that agreement as Non-Participating Manufacturers ("NPMs") MSA § II(cc).[2] The pertinent provisions of the MSA are described in the Petition for Certiorari (pp. 3-8). The *amici* brought a class action on behalf of themselves and all other NPMs doing business in New York seeking injunctive relief against the Attorney General of New York and its chief financial officer prohibiting them from enforcing the New York State escrow statute that penalizes the output of NPMs as well as its Contraband Statute providing for forfeiture of the stamping license of any NPM that does not make full escrow payments. *FH VII* at *1. The MSA requires enactment and enforcement of escrow statutes substantially identical terms in all Settling States. MSA § IX(d)(2)(E) & (F). *FH VII* at *2. The Contraband Statutes, also in substantially identical terms, are enacted in 44 of the other 46 Settling States. They were enacted to

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[1] In accordance with Supreme Court rules, *Amici Curiae* have an interest in the outcome of this appeal and submit this brief to bring to the attention of the Court relevant matter not already brought to its attention by the parties. Sup. Ct. Rule 37.1. The parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici curiae* or their counsel made a monetary contribution to its preparation or submission.

[2] The MSA is available in PDF form at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf.

enforce the covenant the States gave to the Majors to "diligently enforce" these Escrow Statutes. MSA § IX(d)(2)(B).

The Second Circuit has upheld *in personam* jurisdiction in the Southern District of New York over the Attorneys General of the various Settling States in the Southern District of New York finding that they collectively negotiated with the four Original Participating Manufacturers in the MSA (referred to herein as "OPMs" or the "Majors"), controlling over 90% of the national cigarette market in setting up the MSA that settled their potential, present and future product liability claims against the Majors for healthcare costs created by false promotion and claims of safety by the Majors for their cigarettes. *Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 165-68 (2d Cir. 2005) ("*Grand River*"). *Grand River* held that an interlocking grid of these substantially identical output penalties, if proved to have resulted in higher prices nationwide would violate the dormant Commerce Clause. Art. I, § 8, cl. 3. The complaint in *Freedom Holdings* alleges that the enforcement of these statutes throughout the Settling States penalizing the output of NPMs violated both Section 1 of the Sherman Act, 15 U.S.C. § 1 and dormant Commerce Clause. Accordingly, a judgment against the New York Attorney General in *Freedom Holdings* prohibiting enforcement of the New York Escrow and Contraband Statutes will subject the attorneys general in the other Settling States to injunctive relief in the Southern District of New York and collaterally estop them from contesting such relief.

The prosecution of *Freedom Holdings* has been the subject of three reported district court decisions and four Second Circuit rulings.[3]

FH I, 357 F.3d at 223-24, held that if the factual allegations of the complaint before it were proved, it would establish that the State enforcement penalty statutes on NPMs were an integral of the MSA restraint of trade that established a violation of Section 1 of the Sherman Act. *FH I*, 357 F.3d at 223-24. It rejected as a matter of law the arguments of the Attorney General that these statutes constituted independent and unilateral acts of State enacted by the State in its governmental capacity. *Ibid.* Both *FH I* and *FH II*, in denying a petition *en banc* defense for rehearing filed by the Attorney General, also held that the state action immunity created in *Parker v. Brown*, 317 U.S. 341 (1943), was unavailable to the Attorney General because of the State's failure to actively supervise the pricing activity of the Majors. Following Supreme Court precedents, it ruled that such active supervision of pricing by the Majors was necessary for these enforcement statutes to qualify for such immunity. *FH I* at 231-32; *FH II* at 153. This latest Second Circuit decision, *FH VII* effectively overruled *FH I*,

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[3] *See Freedom Holdings, Inc. v. Spitzer* ("*FH I*"), 357 F.3d 205 (2d Cir. 2004); *Freedom Holdings, Inc. v. Spitzer* ("*FH II*"), 363 F.3d 149 (2d Cir. 2004); *Freedom Holdings, Inc. v. Spitzer* ("*FH III*"), 447 F. Supp. 2d 230 (S.D.N.Y. 2004); *Freedom Holdings, Inc. v. Spitzer* ("*FH IV*"), No. 02 Civ. 2939, 2004 WL 2251668 (S.D.N.Y. Oct. 6, 2004); *Freedom Holdings, Inc. v. Spitzer* ("*FH V*"), 408 F.3d 112, 115 (2d Cir. 2005); *Freedom Holdings, Inc. v. Cuomo* ("*FH VI*"), 592 F. Supp. 2d 684 (S.D.N.Y. 2009); *Freedom Holdings, inc. v. Cuomo* ("*FH VII*"), ___ F.3d ___, 2010 WL 4055566 (2d Cir. 2010).

FH II and *Grand River*, and is the subject of a petition to the Second Circuit for rehearing *en banc*, filed by the *amici* herein on November 1, 2010. That petition is currently pending.

FH VII held that as a matter of law, the State enforcement statutes penalizing the output of NPMs were unilateral acts of State that did not authorize or mandate illegal *per se* conduct by private parties and thus were not part of or in furtherance of an illegal *per se* scheme. *FH VII* at *8-*10. It also held that the Attorney General had established the affirmative defense of State action immunity, ruling that active supervision of the pricing activity of the Majors was not required, *FH VII* at *13, *19. *FH VII* further held that NPMs lacked standing under the antitrust laws to seek an injunction against enforcement of these State penalty statutes that have substantially eliminated competition in the Settling States. This was a *sua sponte* ruling. *FH VII* at *9.

As to the dormant Commerce Clause claim, U.S. Constitution, Art. I, § 8, cl. 3, *FH VII* effectively overruled *Grand River*. It did so by creating a *sua sponte* conclusion, contrary to undisputed fact, that the conduct of the States in collectively entering into the MSA and jointly pledging therein to the Majors that they would all enforce these output penalty statutes, MSA § IX(d)(2) simply consisted of independent uncoordinated acts by each of the Settling States, merely requiring "coincident obligations [by the NPMs] which may produce parallel price increases among the States." *FH VII* at *24. This *sua sponte* finding was made despite the acknowledgment in *FH VII* that the enforcement throughout the Settling States of these substantially identical statutes "has caused

cigarette prices to rise nationwide." *FH VII* at *23.

The resolution of the legal issues raised by the Petition for Certiorari are essentially the same as those presented in the Petition for Rehearing *en banc* in *FH VII*. These issues are fundamental ones going to the legality of the exercise of powers by a combination of States to set up and actively participate on a nationwide scale in commercial ventures with private industry. This activity consists of their collectively passing and enforcing state statutes penalizing unfavored firms in a particular industry to protect the market share of their partners, the firms in the MSA. Rather than the Court's passing forthwith on the instant Petition for Certiorari, we respectfully submit that it should hold a decision on the instant petition in abeyance pending a decision by the Second Circuit on the Petition for Rehearing *en banc* in *FH VII*. In the event the Second Circuit denies the Petition for Rehearing *en banc* on *FH VII*, then the *amici* will promptly file a petition for *certiorari* to this Court and ask that it be considered in conjunction with the instant petition in this case. In the event that that Petition for Rehearing *en banc* is granted, there is a substantial probability that the New York Attorney General, supported by the other Attorneys General in the Settling States will then seek a review of that ruling.

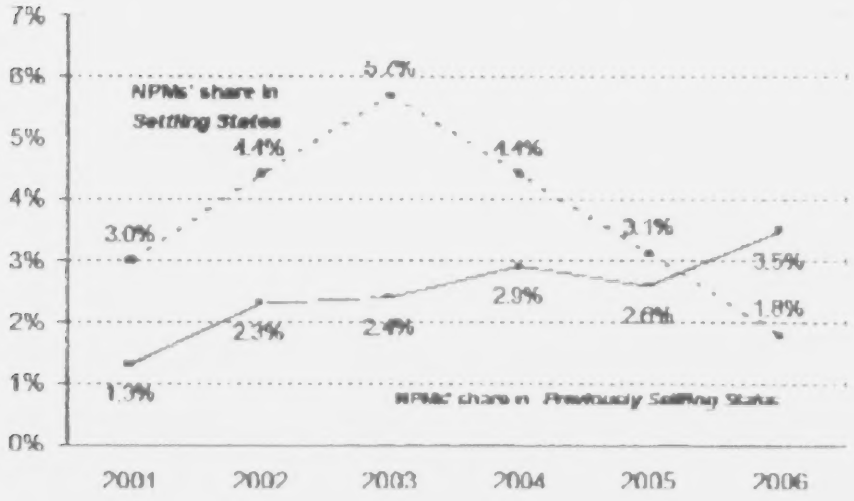
STATEMENT OF FACTS

The undisputed facts set forth herein establish the virulence of the MSA created anticompetitive statutory restraints. Counsel for the petitioners herein have informed us that the confidentiality

agreements entered in the trial court below suppressed most of these facts. These facts are in the public record in *FH VII* and will be briefly summarized here.

There are four Previously Settled States (the "PSS"). Each of them made independent settlement agreements with the Majors shortly prior to the Majors' inducing the Settling States to enter into the MSA in 1998. None of those PSS settlement agreements required any of them to enact statutory output penalties on the NPMs. The virulence of those restraints in the Settling States is graphically displayed in the following chart:

NPMs' Market Share in Previously Settling States vs. Settling States, 2001-2006
(per State Excise Tax data)



As revealed by the foregoing chart, the NPMs in the Settling States were able to compete through 2003, even after paying the output penalty contained in the Escrow Statute, although not as successfully as the NPMs in the PSS. Starting in 2000, however, the repeal of the Allocable Share Release provision (the "ASR")—the so-called

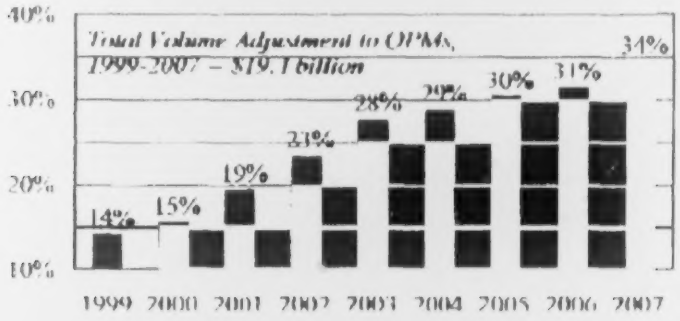
"Amendment" to the ASR that substantially upped the output penalties on NPMs, discussed *infra* at pp. 11-12, began to be enacted throughout the 46 States. By the end of 2006, this Amendment of the ASR throughout most of the Settling States had effectively eliminated the NPMs as viable competitors in the Settling States. Thus, by the end of 2006, the NPM sales in the four PSS were nearly double the sales of the NPMs in the 46 Settling States, and the market share of the NPMs in the Settling States has continued to decline, virtually eliminating them in the Settling States.

The Agreed Upon Output Restraints Contained In The MSA Itself

There are two output restraint mechanisms in the MSA: The Relative Market Share Adjustment, and the Volume Adjustment, MSA § IX(c)(ii). The Relative Market Share Adjustment penalizes any Major that gains market share at the expense of the other. It pegs the amount each Major pays as its share of the Base Annual Payment to the amount of cartons it sells nationally each year. Thus, the more share it gains, the more it has to pay to the others. The Volume Adjustment, an across-the-board bonus to all of the Majors, provides an incentive for all of them to reduce volume by raising prices. The less the Majors collectively sell in any given year, the less their annual settlement payment is to the Settling States. As the trial court explained in *FH III* at 257, "it rewards decreasing sales and punishes increases." Thus, the Majors have raised the prices virtually every year. This has reduced by billions of dollars of every year the annual settlement the States

receive from the Majors, as shown by the following chart:[4]

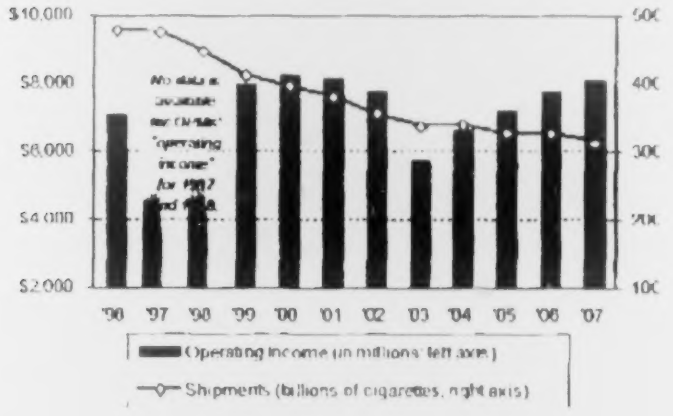
Rebates to the OPMs of MSA Annual Payments Due to Volume Adjustment (MSA Exh. E)



The objective of an output cartel is to increase operating profits of the participating firms by decreasing the amount of goods sold while at the time raising the unit prices of those goods. As shown by the following chart, the MSA output cartel has achieved this:

OPMs' Operating Income and Shipments

1999-2007

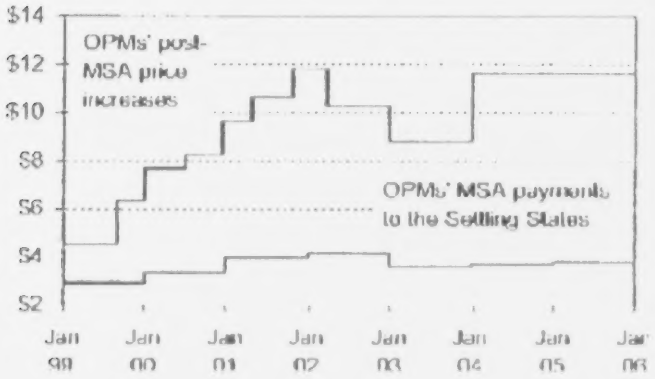


[4] All of the charts appearing in this petition come from the Opening Brief on appeal in *FH VII* and are based on data of record in the trial.

As the following chart reveals, the OPMs virtually doubled the wholesale price of premium cigarettes by a succession of price rises starting in late 1998, when the MSA went into effect, and continuing through 2001:

History of OPM's Price Rises (per carton)

1999-2005

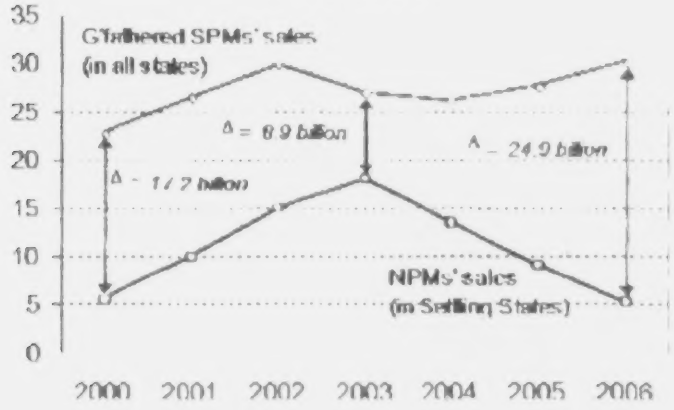


Starting in 2002 and continuing on through 2003, these price rises resulted in a decline in the operating income. This was due to a shift from the premium market occupied fully by the Majors to the lower priced end of the market, the deep discount market, where the NPMs and the grandfathered SPMs compete with each other. As noted, *supra*, p. 6, however, due to the continuing elimination of NPM sales starting in 2004, the Majors have pushed their prices back up to 2002 levels and restored their operating profits to 2001 levels.

As noted in *FH VII* at *1, grandfathered Subsequent Participating Manufacturers ("SPMs") are those small cigarette manufacturers in existence at the time the MSA became effective. To induce them to join the MSA, they were offered a perpetual bonus for signing within the ninety day

period following the execution of the MSA. This bonus consisted of an exemption from making any per carton annual settlement payments to the Settling States on all sales that did not exceed their 1998 market share or 125% of their 1997 market share, whichever was greater. MSA § IX(i)(1). This exemption, coupled with the repeal of the ASR, has enabled them to take away most of the NPM sales in the Settling States, as shown by the following chart:

NPMs' Sales Versus Grandfathered SPMs' Sales 2000-2006



The Origin And History Of Per Carton Penalties Imposed Upon the NPMs Through the Escrow Statutes

Both the Settling States and the Majors originally labored under the misapprehension that the accepted constitutional protections prevented them from totally controlling interstate commerce by compelling NPMs to make annual payments to the Settling States equivalent to those imposed on the non-grandfathered SPMs whose full MSA

annual settlement payments effectively disable them from competing.

Accordingly, the MSA had two provisions to overcome this constitutional obstacle: 1) It provided that Non-Participating Manufacturers would not make settlement payments to the States, but rather make per carton annual payments into State escrow accounts theoretically to pay for product liability judgments the States might ever recover from them,[5] and 2) the escrow fund payments would not be based upon national sales but only to those States in which they were doing business. Thus, the Escrow Statute, as originally set forth in the MSA Model Statute, MSA Exh. T, contained the Allocable Share Release. It allowed any Non-Participating Manufacturer to obtain a release from escrow of any payments made to the escrow fund of any particular Settling States of any excess over what that State would have received from that NPM as its share of the MSA Base Annual Payment if that NPM would have been a Subsequent Participating Manufacturer. The trial court in *Freedom Holdings* recognized that this was the intent of the Allocable Share Release Provision. *FH III*, 447 F. Supp. 2d at 241-42.

An SPM who joined the MSA after the 90-day period for becoming a grandfathered SPM expired is required to pay the full Base Annual Payment

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[5] No such suits have ever been filed and *a fortiori* no such judgments ever entered against any NPM. Nevertheless, this theoretical justification with proviso that the escrow funds would be returned to them on a 25-year revolving basis was upheld as providing compliance with the Equal Protection and Due Process requirements. *See Star Scientific, Inc. v. Beales*, 278 F.3d 339 (4th Cir. 2002).

without the grandfathered share exemption. Like the NPMs in the Settling States, these non-grandfathered SPMs are all small manufacturers that operate in the deep discount market. For all intents and purposes, these full annual payments disable them from competing since they pay approximately as much as an NPM would pay if it makes the full escrow payment. *See FH VI* at 592 F. Supp.2d at 692.

In 2002, the Counsel of State Governments ("CSG") representing all of the States issued a report warning them that they would "experience a $14 billion decrease in projected tobacco settlement revenue over the next nine years" unless NPM sales were suppressed, *FH VII* Appendix A502. Consequently, the OPMs collaborated with the Settling States in jointly conducting a state-by-state campaign to repeal the ASR and in effect convert NPMs into involuntary Non-grandfathered SPMs, thereby disabling them from competing. A814-18. The campaign, kicked off in early 2003, began to pay dividends starting in that year. The trial court recognized that "[t]he provisions of the MSA motivating State action, MSA Art. IX and the pressures imposed by the OPMs in light of their declining profits" appeared to be the motivating factor for this quick and widespread enactment of the ASR. *FH IV*, 2004 WL 2251668, at *1.

As is apparent from the charts on p. 6 and p. 10, *supra*, once the Allocable Share Repeal converting NPMs to involuntary SPMs began to take place starting in 2004, the MSA output cartel achieved a success unparalleled so far as we know by any other output cartel ever conceived. Starting in 2004, the Majors' operating income began to

attain the record levels that it had attained in 2000 and 2001 while their sales volume continued to decline—with, of course, lower annual settlement payments being made to the Settling States, due to that decline in volume. *See* charts p. 8, *supra*.

ARGUMENT

I. THE COLLECTIVE ENFORCEMENT BY THE SETTLING STATES OF THEIR STATUTES PENALIZING THE OUTPUT OF NPMs IN FURTHERANCE OF THE OUTPUT CARTEL SET UP IN THE MSA IS A CLEAR-CUT VIOLATION OF SECTION 1 OF THE SHERMAN ACT

It is ironic that the Attorneys General of the Settling States whose sworn duty is to protect the citizens therein are actively participating in and enabling the predatory behavior of the Majors in fleecing them.

None of the appellate decisions upholding the legality of these statutes under the Sherman Act, including both *FH VII* and *S&M Brands*, mention, much less deal with the proven fact that, the enforcement of these penalty statutes within the Settling States has virtually wiped out NPM competition within those States—the relevant market for Sherman Act purposes—with the resulting nationwide high prices to consumers. That it has happened is undeniable. Preventing such restraints was what the Sherman Act was designed to prohibit. If such a restraint produced by the collective action taken by most of the States

in the nation does not violate the Sherman Act, then it is reduced to a vapid piece of legislation.

A. Both *FH VII* And *S&M Brands* Are Able To Conclude That The Statutory Enforcement Penalties Do Not Create A Violation Of Section I Of The Sherman Act Only By Their Refusal To Look At The Relevant Market

Neither *FH VII* nor *S&M Brands* provides any explanation as to why they refused even to look at the anticompetitive effects of these output penalty statutes within the relevant market—the Settling States. The elimination of the NPMs in this market is self-evident, as shown by the charts on p. 6 and p. 10.

S&M Brands, like *FH VII*, applies antitrust precepts facially inapposite to these *sui generis* statutory penalties. For example, *S&M Brands*, just as *FH VII* does, concludes that there is no *per se* violation created by these Escrow Statutes because they "did not 'mandate or authorize conduct that necessarily constitutes a violation of the antitrust laws in all cases.'" 614 F. 3d, 172, 176 (5th Cir. 2010), quoting *Xcaliber Int'l Ltd. v. Caldwell*, 612 F.3d 368, 375 (5th Cir. 2010.) But such analysis ignores the objective in the MSA for enacting and enforcing these State penalty statutes. *S&M Brands* does not challenge the point that the State of Louisiana did in fact act "as a private player when it entered an agreement with other States and the OPMs to restrain trade." 614 F.3d at 176. In entering into the MSA, as pointed out above, Louisiana and the other Settling States covenanted with the Majors that they

would enact and enforce these statutes, and that unless they "diligently" enforced them they would be subject to multibillion dollar reductions in their annual settlements. MSA § IX(d)(2)(B). In enforcing these statutes to avoid these reductions, it is the States themselves that "as private players" are carrying out the mandate of the OPMs, not vice versa. Thus, using this test to sanitize this illegal conduct on the part of the States is topsy turvy reasoning.

S&M Brands then goes on to conclude that "the MSA and Escrow Statute working together" do not create an antitrust violation. It relies on this conclusion primarily on a quotation of *Tritent Int'l Corp. v. Kentucky*, 467 F.3d 547, 557 (6th Cir. 2006), to the effect that the "genesis of [the] anticompetitive behavior" complained about by the NPMs results not from enforcement of these statutory penalties on output but rather "the behavior with which *Tritent really* takes issues is the behavior of the PMs following the MSA's enactment," *i.e.*, the "PMs' practice of increasing cigarette prices, thus keeping sales volume down, [which] has allowed them to maintain a stable market share." As facts show, however, these supracompetitive OPM price rises are enabled by and depend upon the enforcement of these State statutory penalties on the output of NPMs. Again, this is a topsy-turvy analysis.

In short, these misapplications of basic antitrust principles in the appellate courts upholding these MSA statutes ignore the indisputable facts that the MSA and its implementing statutes penalize NPM output: a) they were enacted with the objective of compelling the States to penalize the out-

put of non-participants in the cartel, and b) they have enabled the Majors and grandfathered SPMs to overcharge consumers billions of dollars every year.

II. THE SAME UNDISPUTED FACTS ESTABLISHING THE DORMANT COMMERCE CLAUSE VIOLATION ALSO ESTABLISHED THE COMPACT CLAUSE VIOLATION

The agreed-upon covenant, MSA § IX(d)(2)(B), jointly and severally made by the Settling States to the Majors for enacting and enforcing these statutory penalties on output of the NPMs and the achieved objective of raising cigarette prices nationwide, constitute a compact within the meaning of the Compact Clause, Art. I, § 10, cl. 3. The performance of that compact has resulted in a nationwide regulation of the interstate commerce in cigarettes with consumers nationwide paying the price. Unless the Compact Clause is a meaningless provision, this has to constitute a violation of it.

CONCLUSION

The adjudication of the petition for *certiorari* should be held on abeyance pending final resolution of the *Freedom Holdings* petition *en banc* in the Second Circuit.

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Respectfully submitted,

PATTERSON BELKNAP WEBB
& TYLER LLP

By: _____
David Dobbins (DD 3278)
Nicolas Commandeur (NC 4280)

1133 Avenue of the Americas
New York, New York 10036
(212) 336-2000

Attorneys for Plaintiffs-Appellants Freedom Holdings, Inc. d/b/a North American Trading Company and International Tobacco Partners, Ltd.